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LOCAL GOVERNMENT IN JAPAN: NATIONAL AND INTERNATIONAL ASPECTS

Summary

As economic relations between the United States and Japan have become more complicated, negotiators on both sides of the Pacific increasingly have focused on policies and practices in the other country that fall under the heading of domestic or even local. For example, a number of the barriers Washington cited during the Structural Impediments Initiative talks -- high land prices, a complex distribution system and administrative guidance -- result at least in part from local government actions. Furthermore, American firms, backed by U.S. negotiators, are pushing for changes in the government procurement process at both the national and the local level. In various ways, therefore, local government policies and practices have an international impact.

In Japan local autonomy is limited. Although three-fourths of total public-sector expenditures are undertaken by local governments, prefectural and municipal tax revenues cover barely 40 percent of their expenditures. Tokyo supplies most of the remaining funds. That gives central government officials a major say in the shape of many local programs. It also forces prefectural and municipal authorities to consult frequently with the central government and to stay on good terms with officials in Tokyo if they want to get a bigger share of the pie for their area.

Ongoing reviews of the relationship between the central and local governments by public-sector advisory panels and several private-sector groups have looked at how to balance economic development across Japan and strengthen the autonomy of local authorities. These reviews have examined the possibility of transferring some regulatory authority from Tokyo to local entities,

changing the central government's revenue-sharing formula, reshuffling existing local administrative units plus relocating the national capital. Implementation of these administrative reforms could contribute to resolving a number of the structural problems cited by Washington at the SII talks and eventually could provide more business opportunities for foreign companies in Japan.

Local Government and Its History in Japan

A two-layered local government system came into being during the late 1870s and the 1880s when the Meiji government introduced Western-style political institutions based on the first constitution in Asia. At the most basic level are 656 *shi* (cities), 1,998 *machi* (towns) and 585 *mura* (villages). These municipal units are responsible for various local services, such as construction and maintenance of roads, bridges and parks, elementary and secondary education, social welfare, garbage collection and public health.

Between these local authorities and the central government are 47 prefectural governments, including 43 *ken* (prefectures) plus the administrative units for the metropolitan areas of Tokyo, Osaka and Kyoto and for the island of Hokkaido. This level of government handles intermunicipal public programs, like major highways and other transportation links, water supplies and high school education. The prefectural governments also coordinate municipal programs and mandates from the central government. Except for the Tokyo metropolitan government, which serves as a prefectural authority as well as a city authority for Tokyo's 23 districts, there are no differences in the functions performed by prefectural governments, even though some of the units go by different names.

The cabinet also has authorized several large cities, almost all of which have more than 1 million residents -- Sapporo, Sendai, Kawasaki, Yokohama, Nagoya, Kyoto, Osaka, Kobe, Hiroshima, Kitakyushu and Fukuoka, to perform some of the functions normally reserved for prefectural governments. Chiba will be added to this list in April 1992.

From the earliest days under the Meiji government, which engineered Japan's Western-style modernization through strong initiatives led by the central authority, local administrative units were regarded as the tools that could implement policy formulated by the national government, particularly the Ministry of Interior, which dealt with police, public works, health, welfare and local administrative affairs. This central-oriented structure mostly copied the German model, in which modernization was initiated under strong leadership from Berlin.

After World War II American occupation forces had a hand in revising the local government system. The new constitution ensured the autonomy of local governments. Governors, mayors and assembly members were to be elected by local

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residents. Plus, local assemblies received expanded authority to decide budgetary matters and local regulations as long as they did not run counter to national rules. The autonomy, however, was no more than superficial. To this day that has not changed. The central government continues to control many if not most local government activities by splitting certain national tax revenues with them, providing subsidies, mandating particular operations and drafting regional development programs; administrative guidance also plays a role.

Local Government Budget Authority

Revenues - The toughest challenge facing any local government today is finding enough money to provide the services residents expect. In FY 1989, the most recent fiscal year for which the books have been closed, taxes supplied 62.7 percent of the total revenues collected by local governments in Japan (see Table 1). The rest came from central government subsidies, local government

Table 1: Local Government Finance, FY 1989

(in billions of yen; settlement basis)

	Amount	Share
Revenues		
Local Tax Revenues	Y31,795	42.6%
Local Allocation Tax	13,455	18.0
Other National Tax Revenues Transferred to Local Treasuries	1,482	2.0
Subtotal	46,733	62.7
Grants from Central Government	10,377	13.9
Bonds	5,615	7.5
Other Revenues	11,843	15.9
Subtotal	27,835	37.3
Total	74,567	100.0
Expenditures		
Administrative Costs	9,309	12.8
Social Welfare	7,717	10.6
Health	4,102	5.6
Labor Affairs	460	0.6
Agriculture, Forestry and Fisheries	4,807	6.6
Commerce and Industry	3,055	4.2
Public Works	16,410	22.6
Fire	1,262	1.7
Police	2,436	3.3
Education	15,284	21.0
Debt Service	6,355	8.7
Other Expenditures	1,534	2.1
Total	72,729	100.0

Source: Ministry of Home Affairs, Chiho Zaisei Hakusho (White Paper on Local Government Finance), 1991.

borrowing and other sources, such as profits from lotteries or races. Revenues from taxes levied by local governments themselves represented two-thirds of the total tax take; the remainder came from national taxes, which the central government divvies up to help even out the discrepancy between local tax revenues in wealthier and poorer areas (see below).

In FY 1989 prefectural governments got 44.4 percent of their total tax revenues from what is known as the enterprise tax -- a tax on corporate or self-employment income. The prefectural inhabitants tax generated 29.4 percent of receipts; this tax is levied on residents' personal income or the capital of companies with offices there. In the same budget year municipal governments derived 54.4 percent of their tax revenues from the municipal inhabitants tax and 33.3 percent from property taxes.

The Local Tax Law and related implementing regulations determine basic tax rates and tax-exempt items. But local governments have some power to raise or lower tax rates. For example, municipal governments can increase personal income tax rates by up to 50 percent of the base level set by law; the comparable adjustment for companies is 20 percent.

In the year through March 1990 the central government transferred Y14.9 trillion ($110.6 billion at Y135=$1.00) in national tax revenues to local governments. This was equal to 23 percent of general account revenues that year. This revenue-sharing mechanism helps to compensate for differences that enable local governments in urban areas -- with their larger populations, higher real estate prices and more extensive business operations -- to raise more tax money than governments serving rural areas.

For example, if the average income of a Tokyo resident is equal to 1, then the incomes of urban residents of Osaka, Kanagawa and Aichi prefectures would rank at 0.76, 0.75 and 0.74, respectively. But residents in the countryside, such as those living in Okinawa, Kagoshima and Aomori prefectures, would have an average income of less than half that of their Tokyo counterparts, or 0.47, 0.48 and 0.48, respectively. Nationwide the average income works out to about 63 percent of a Tokyo resident's income.

Similarly, of the 100 largest firms in Japan (based on FY 1990 taxable income) 66 had their headquarters in Tokyo, 16 in Osaka and five in Aichi prefecture. Tokyo, Osaka, Aichi and Kanagawa prefectures, which together cover barely 3 percent of Japan's land area, had 28.5 percent of the nation's population in 1988. Moreover, they accounted for 35.1 percent of all sales of manufactured goods and 33.9 percent of total retail sales in 1987.

Income disparities by region tell a similar tale. Local tax revenues per person in the Kanto area, which includes Tokyo and six neighboring prefectures, was almost 45 percent higher than the national average in FY 1986 and three times greater than that of Okinawa prefecture (see Table 2).

The central government uses two means to distribute national tax revenues to local treasuries. The first, listed in the general account budget as the local allocation tax, funnels revenues from five taxes: the national personal income tax (32 percent of receipts), the national corporate income tax (32 percent), the liquor tax (32 percent), the tobacco tax (25 percent) and the consumption tax (24 percent). If the monies transferred under this formula are

Table 2: Comparison of Local Government Revenues per Resident by Region, FY 1986

(100 = nationwide average)

Region	Total Revenues*	Local Taxes (A)	Local Allocation Tax (B)	Subsidies (C)	A+B	A+B+C
Hokkaido	129.0	68.9	181.3	161.9	104.7	121.2
Tohoku	124.1	65.8	199.5	154.3	108.4	121.7
Kanto	91.6	144.6	36.1	62.9	110.0	96.4
Chubu	76.9	100.4	58.7	84.0	87.1	86.2
Hokuriku	131.7	90.2	182.6	144.8	119.7	126.9
Kinki	85.7	94.4	52.9	69.8	81.2	77.9
Chugoku	113.7	73.0	158.2	137.7	100.2	111.0
Shikoku	127.8	63.8	223.3	143.3	114.6	122.9
Kyushu	107.5	59.7	174.7	139.1	96.3	108.7
Okinawa	121.3	46.7	220.6	206.4	102.1	132.2
Nationwide	100.0	100.0	100.0	100.0	100.0	100.0

*Includes revenues other than those listed, such as bond issues.

Source: Chiho Zaisei Kyokai (Association of Local Government Finance)

added to local tax revenues, the maximum regional difference in tax revenues per capita narrowed to 19 percent of the national average in FY 1986.

The other transfer of national tax revenues to local governments falls under the special-purpose category. For example, the proceeds from the gasoline tax are distributed to prefectural governments in accordance with the extent of national and prefectural highways within their jurisdictions and the need to maintain and extend these roads. Likewise, receipts from the motor vehicle tonnage tax, paid by people owning cars or trucks, is allocated to municipal governments for maintenance and construction of municipal roads. Revenue from the aviation fuel tax is allocated to prefectural and municipal governments with airports within their boundaries so they can fund measures to counter noise caused by take-offs and landings.

Expenditures - Apart from administrative and debt-servicing costs, local governments spend most of their money on public works, education, social welfare and support for primary industry (Table 1). The central government underwrites a portion of these program costs through grants (see Table 3). In FY 1989, for example, the Ministry of Agriculture, Forestry and Fisheries helped to finance programs that represented 75 percent of what was done at the prefectural and municipal level to assist farmers, loggers and fishermen. Similarly, Ministry of Construction grants provided partial funding for almost two-thirds of the cost of housing projects undertaken by local governments, about two-fifths of their erosion and flood control work, approximately one-third of city planning programs and nearly a third of road and bridge maintenance and construction work. In addition, the Ministry of Education split 29 percent of the cost of public education.

Table 3: Local Government Programs by Funding Source, FY 1989

	Local Programs Partly Funded by Central Government	Local Programs Fully Funded by Local Governments	National Programs Partly Funded by Local Governments	Total
	(in billions of yen)			
Agriculture, Forestry and Fisheries	Y2,429	Y679	Y147	Y3,256
Construction	4,804	5,861	897	11,563
Roads and Bridges	1,412	2,617	505	4,534
Erosion and Flood Control	1,290	537	296	2,124
City Planning	1,125	2,264	6	3,395
Housing	574	294	0	868
Education	750	1,861	0	2,612
Other Programs	489	2,509	0	2,999
Total	8,472	10,912	1,045	20,428
	(share)			
Agriculture, Forestry and Fisheries	74.6%	20.9%	4.5%	100.0%
Construction	41.5	50.7	7.8	100.0
Roads and Bridges	31.1	57.7	11.1	100.0
Erosion and Flood Control	60.7	25.3	14.0	100.0
City Planning	33.1	66.7	0.2	100.0
Housing	66.1	33.9	0.0	100.0
Education	28.7	71.2	0.0	100.0
Other Programs	16.3	83.7	0.0	100.0
Total	41.5	53.4	5.1	100.0

Source: Ministry of Home Affairs, Chiho Zaisei Hakusho (White Paper on Local Government Finance), 1991.

Some national programs, like construction of national highways and erosion and flood control work, require local entities that benefit from the projects to share part of the costs. Local government budgets show these expenditures as transfers to the central government. In reality, however, the direction in which public-sector money flows matters less than that programs at both the national and the local level are financed through a combination of central, prefectural and municipal money. The cabinet decides the cost-sharing formula for various programs and projects in each fiscal year's budget plan. In FY 1991, for example, the central government paid 60 percent of the cost of each national erosion and flood control program and 55 percent of the cost of each similar local government project; the rest of the money for both types of work came from local government budgets.

Since grants from Tokyo are an indispensable part of local governments' finances, especially in rural areas, cultivating good relations with the central government's bureaucracy is one of the most time-consuming aspects of the job for prefectural and municipal administrators. Effective local government officials make frequent visits to the branch offices or even the headquarters of ministries and agencies that control revenue-sharing funds to improve their chances of winning money that is not distributed by formula. They also try to enlist the help of their area's Diet members. Districts represented by powerful politicians in the ruling Liberal Democratic Party reportedly tend to receive more money than others, especially for construction projects, such as national highways and high-speed train lines.

Given the general tendency of government units in rural areas to depend heavily on grants from Tokyo plus the underrepresentation of urban areas in the Diet, the populous Kanto or Kinki regions get just one-third to one-half of the subsidies on a per-capita basis that go to other regions; the Chubu region is the other exception. Furthermore, total per-resident revenues (including local tax revenues, the local allocation tax, grants and other funds) in such rural areas as Hokuriku and Hokkaido exceed the figure for urban areas like Kanto, Chubu and Kinki (see Map and Table 2).

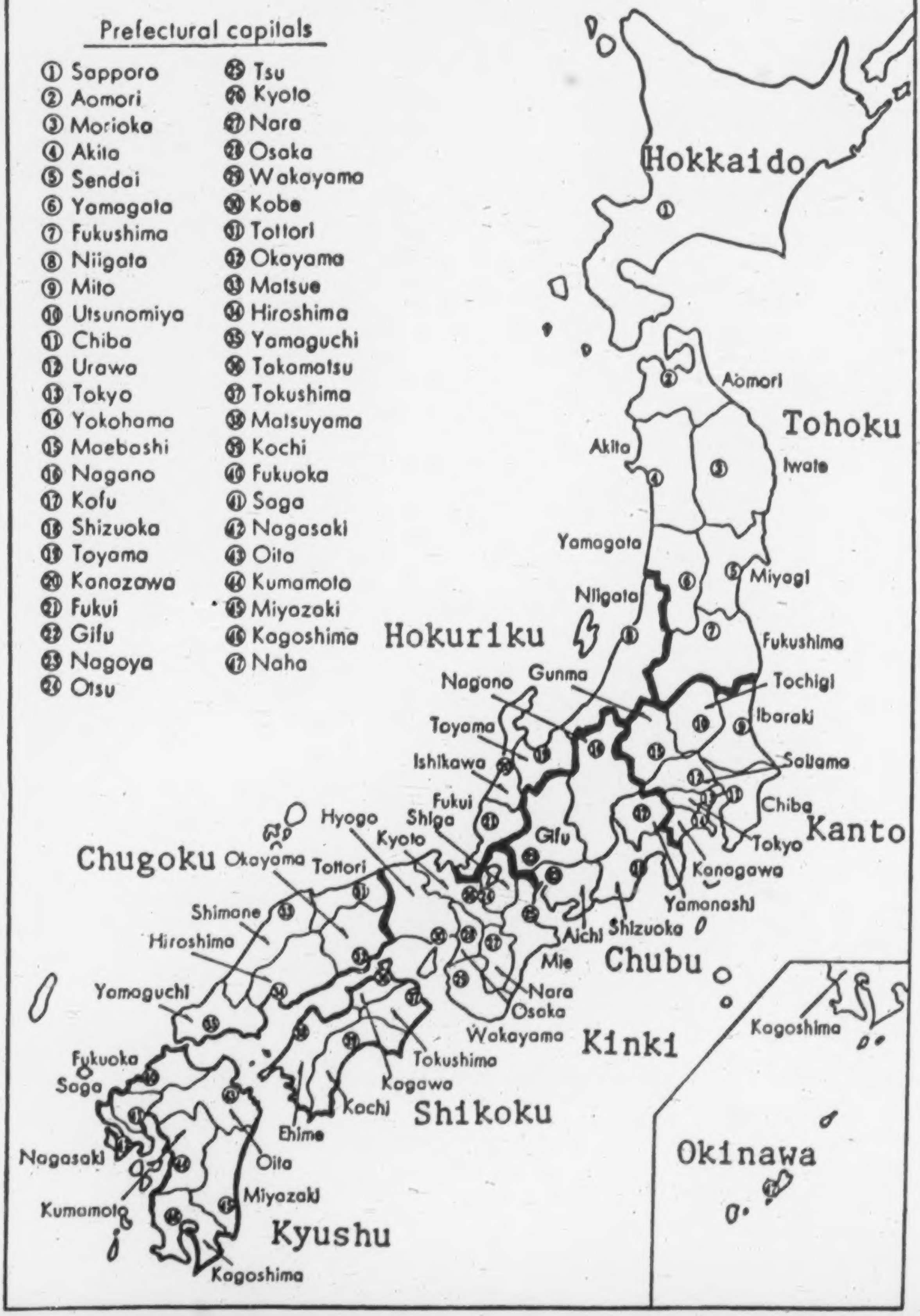
Several analysts say that people who live in Osaka, Kobe, Kyoto and other parts of Kinki have only themselves to blame for the region's relatively small share of the federal pie. In the conventional wisdom, at least, Kinki residents traditionally have been adverse to depending on Tokyo for a significant share of their local governments' money. More important perhaps, a number of city and town governments there are headed by members of the Socialist Party of Japan or other opposition parties. In addition, the bureaucracy in Tokyo is not disposed toward channeling money to areas where local officials earn a lot more than they do and that includes a good part of the Kinki region. With average government salaries 12.8 percent higher than the central government figure in 1990, Sakai, Osaka prefecture, was at the top of the list of cities with high-paid officials; the next eight places on the list also were occupied by cities in Osaka prefecture.

Importance of Local Government Spending

Because of revenue-sharing local government expenditures are much bigger than central government outlays. (The same is true in the United States.) In FY 1989, for example, 62 percent of the Y116.3 trillion ($861.5 billion) spent by the public sector went through prefectural and municipal government budgets (see Table 4). In particular, local governments ended up paying 88 percent of the costs of public education, 80 percent of the expenses connected with land conservation and disaster work and 56 percent of social welfare costs.

Gross national product statistics for the April 1989-March 1990 period underscore the importance of local governments in both public-sector current expenditures and fixed investment -- two areas of major concern to Washington in the SII talks. Local governments accounted for 75 percent of the nearly Y36 trillion ($266.5 billion) in nominal terms that the public sector spent on goods and services. Similarly, nominal fixed investment by prefectures and municipalities represented 77 percent of the Y26.4 trillion ($195.3 billion) the central and local governments devoted to capital formation in FY 1989.

Prefectures of Japan



Prefectural capitals

- ① Sapporo
- ② Aomori
- ③ Morioka
- ④ Akita
- ⑤ Sendai
- ⑥ Yamagata
- ⑦ Fukushima
- ⑧ Niigata
- ⑨ Mito
- ⑩ Utsunomiya
- ⑪ Chiba
- ⑫ Urawa
- ⑬ Tokyo
- ⑭ Yokohama
- ⑮ Maebashi
- ⑯ Nagano
- ⑰ Kofu
- ⑱ Shizuoka
- ⑲ Toyama
- ⑳ Kanazawa
- ㉑ Fukui
- ㉒ Gifu
- ㉓ Nagoya
- ㉔ Otsu
- ㉕ Tsu
- ㉖ Kyoto
- ㉗ Nara
- ㉘ Osaka
- ㉙ Wakayama
- ㉚ Kobe
- ㉛ Tottori
- ㉜ Okayama
- ㉝ Matsue
- ㉞ Hiroshima
- ㉟ Yamaguchi
- ㊱ Takamatsu
- ㊲ Tokushima
- ㊳ Matsuyama
- ㊴ Kochi
- ㊵ Fukuoka
- ㊶ Saga
- ㊷ Nagasaki
- ㊸ Oita
- ㊹ Kumamoto
- ㊺ Miyazaki
- ㊻ Kagoshima
- ㊼ Naha

Hokkaido
Aomori
Tohoku
Akita
Iwate
Yamagata
Miyagi
Niigata
Hokuriku
Fukushima
Gunma
Nagano
Tochigi
Toyama
Ibaraki
Ishikawa
Saitama
Fukui
Chiba
Hyogo
Shiga
Kanto
Kyoto
Gifu
Tokyo
Chugoku
Okayama
Tottori
Kanagawa
Yamanashi
Shimane
Aichi
Shizuoka
Hiroshima
Mie
Chubu
Nara
Yamaguchi
Osaka
Wakayama
Kinki
Kagoshima
Tokushima
Fukuoka
Saga
Kagawa
Kochi
Shikoku
Ehime
Okinawa
Nagasaki
Oita
Miyazaki
Kumamoto
Kyushu
Kagoshima

Table 4: Total Expenditures by Central and Local Governments, FY 1989

(in billions of yen; settlement basis)

	Central Government	Local Government	Total	Local Government Share
Administrative Costs	Y2,858	Y13,845	Y16,703	82.9%
Defense	3,920	0	3,920	0.0
Land Conservation and Disaster Work	4,359	17,654	22,012	80.2
Support for Agriculture, Commerce and Industry	4,359	4,584	8,943	51.3
Education	2,076	15,177	17,253	88.0
Social Welfare	11,124	13,853	24,977	55.5
Debt Service	12,090	6,355	18,445	34.5
Other Expenditures	3,864	190	4,054	4.7
Total	44,649	71,658	116,307	61.6

Note: The total for local government expenditures differs from that listed in Table 1 mainly because central government programs partly funded by local governments are counted as local government expenditures in Table 1 but as central government expenditures in this table. Subsidies from the central government to local governments are treated as local government expenditures in both tables. Administrative costs in this table include outlays for police and fire; these expenses are listed separately in Table 1. Similarly, expenditures for health, labor affairs and part of public works spending, such as housing, are included here as social welfare expenditures.

Source: Ministry of Home Affairs, Chiho Zaisei Hakusho (White Paper on Local Government Finance), 1991.

Problems in Regional Development

Despite the significant amount of money spent year after year by local governments, particularly in rural areas, the economic situation outside Japan's urban areas has not improved substantially. Population continues to flow from rural areas to cities in spite of the problems associated with metropolitan life, such as the high cost of housing and overcrowded transportation systems.

Urbanization also has accelerated because of the younger generation's tendency to study in metropolitan areas and then find jobs there. A survey by the Ministry of Education showed that from 1989's graduating college class of 300,019 students, 97,489 were graduated from schools in Tokyo, 27,049 in Osaka, 19,803 in Kanagawa prefecture, 19,281 in Aichi prefecture and 18,348 in Kyoto. Not only did more than 60 percent of the students graduate from universities in urbanized areas but most of them were recruited by companies that also were located in major cities. Only about 30 percent of the graduates of universities in other prefectures continued to work in the same prefectures where they go to school. This points to both a relatively small number of universities in nonmetropolitan prefectures and a scarcity of job opportunities for highly educated students in these areas.

Prefectural governments in rural and semiurban areas generally devote considerable time and money to attracting new businesses. These efforts are designed to provide job opportunities so the younger generation will not move away and to increase the tax base. The current relationship between local governments and the central government, however, sometimes tends to blunt the effectiveness of these initiatives. Prefectures and municipalities not only look to Tokyo to fund part of the cost of their business promotion programs but they also are dependent on the central government for much of the money needed to improve their industrial infrastructure, such as transportation links, and to provide the services that will attract new business. In short, local governments trying to implement major industrial development programs often find themselves at the mercy of central authorities.

Although Tokyo heralded its FY 1988-FY 1989 furusato (hometown) program, in which each prefecture and municipality received a Y100 million ($740,700) grant to carry out whatever programs it desired, central government officials always have exhibited more interest in local industrial development programs that they design and manage than in those initiated by the prefectures. These central government programs include the new industrialized cities project undertaken in the 1960s to relocate heavy industry away from metropolitan areas and the Ministry of International Trade and Industry's ongoing technopolis program, aimed at developing a series of high technology-oriented zones. Likewise, highway, railroad and air transportation development programs focus mainly on improving local areas' access to Tokyo or other metropolitan areas rather than on building up intraprefectural transportation networks.

Some critics argue that central government-designed development programs, oriented as they are to business centers, have discouraged local community leaders from taking the initiative in drafting their own development projects. The more that local governments in rural and semiurban areas depend on the central government, the more that residents and businesses in these places will tend to move to Tokyo, these critics say.

Administrative Reform Tackles Decentralization

Growing calls from prefectural and municipal officials as well as business leaders for greater local government autonomy have put the relationship between the central and local governments on the agenda of a series of administrative reform panels created by recent prime ministers. Since 1981 these groups have issued a dozen reports; 10 have referred to local government issues.

A December 1989 report dealt most comprehensively with relations between the central and local governments. The panel proposed that local government finances be made less dependent on federal largesse. Among the suggested options were: a review of the local allocation tax system and its distribution, more flexibility for local entities to issue bonds, and reduced subsidies from the central government. At the same time the panel suggested that local governments make their own operations more efficient; that would reduce their dependence on central government funding. Privatization of public corporations was recommended in this context.

The report also urged Tokyo to reduce as much as possible its use of administrative guidance to influence the activities of local governments. A similar recommendation was made concerning regulatory control of matters that really are local government decisions. To cite just one example, local governments have to obtain clearance from the Ministry of Transportation before they can change bus routes. At the same time the advisory panel proposed a review of local government functions mandated by Tokyo, such as licensing and registration, to see if duplication can be eliminated when there is overlapping jurisdiction. Not only do both levels of government regulate the opening of supermarkets, department stores and other big retail outlets under the Large Retail Store Law as well as the contruction of factories, but each also has a say on such matters as whether a barbershop or a dry cleaner can go into business and if a hotel, school or hospital can be built.

In the most recent report, issued this past July, the administrative reform group focused on improving the standard of living in Japan by, among other measures, transferring some central government functions to local entities, reducing gaps in the economic and social development of metropolitan centers and rural or semiurban areas, and resolving urbanization problems, including the high cost of housing. The report stressed the necessity of breaking down Japan's central-oriented administrative system and establishing autonomous local governments to cope with current social and economic problems.

Following up on the recommendations contained in the December 1989 report, several concrete measures were outlined to give prefectures and municipalities more freedom to handle local affairs. For example, the report suggested that local governments have independent sources of revenue to fund such services as social welfare, education and cultural activities. Community members should have input in city planning decisions and the design of local industry promotion programs, the report said. It also urged local governments to establish community colleges and provide other educational programs to keep the younger generation interested in staying and studying in their home community. Other proposals included creation of transportation and information links between core local cities, which, the report said, should be encouraged more than networks between Tokyo and local cities. In line with calls to shift many central government functions to the local level, panel members said the preferred system is a small, efficient central government with responsibilities limited to such areas as defense and diplomacy.

Although both the 1989 and the 1991 reports emphasized the need to review the current structure of local government as part of the process of examining the transfer of central government functions to prefectures and municipalities, neither advisory panel spelled out what type of local government unit would be best-suited to handling additional responsibilities. Some local business organizations and think tanks have suggested that prefectural governments in such areas as Kanto, Chubu and Tohoku be replaced by regional governing bodies. Another proposal is to meld cities and neighboring towns into larger municipal units, each of which would have a population of around 300,000.

A much talked-about plan being studied by the government, the Diet and the private sector involves relocating the national capital and its administrative functions. Common to all these studies is the basic concept of replacing the current centrally oriented administrative system with a decentralized, locally oriented system of government.

Improving the Business Atmosphere for Foreigners

Many of the suggested administrative reforms also would be beneficial to foreign companies eyeing or operating in the Japanese market. Transferring regulatory power to prefectures and municipalities would streamline the approval process and other administrative procedures that firms must navigate to do business in Japan. Thus, business deregulation would be accelerated through decentralization. In addition, putting more regulatory power in the hands of local officials might persuade companies that they do not have to maintain offices in Tokyo to operate efficiently; that would trim costs.

Shifting more government functions to the local level also might foster the expansion of the economic infrastructure in nonmetropolitan areas. If, in addition, local governments had greater flexibility to offer incentive packages to potential investors, companies, including foreign firms, would have more options on where to locate their offices, factories and other facilities. Locating outside Tokyo and other metropolitan areas provides businesses savings beyond those associated with the cost of owning or leasing space; labor costs, for example, generally are lower in nonurban areas.

Outlook

The tradition of a centrally oriented government system, including the dependence of prefectures and municipalities on Tokyo for money, will not be easy to change over the short run. Opposition to decentralization still runs strong in certain quarters, especially among central government officials who exercise considerable authority over local government affairs. But interest in change is mounting in at least one part of the central government, the Ministry of Finance.

With national personal and corporate income tax revenues running behind projections in the current fiscal year (see JEI Report No. 41B, November 1, 1991), MOF budget officials have started to review the revenue-sharing system. They reportedly are considering a substantial cut in the amount of money transferred to local governments beginning in FY 1992. Under study is a reduction in the percentage of national tax revenues automatically transferred to prefectures and municipalities via the local allocation tax; subsidy programs also are being examined.

Increasing the chances that something, however modest, will be done in the upcoming fiscal year is the projection of higher FY 1992 local government revenues. Real estate taxes, in particular, are expected to be up because property values, last appraised for tax purposes in 1988, were reassessed this year. But cutting back on revenue-sharing is unlikely to be a cost-free move for Tokyo. No doubt it will have to give local governments more power.

Shifting power to local governments could lead to more fragmented administration and regulation, as happens in the decentralized United States. On balance, though, decentralization, very much a domestic issue, should result in a more open business climate for foreign firms in Japan.

For further information, contact Tadashi Saito.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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REPORT

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Miyazawa Elected Prime Minister

After weathering nearly 40 years of the trials, tribulations and vicissitudes of Japanese politics, Kiichi Miyazawa, the new president of the ruling Liberal Democratic Party, finally grabbed the brass ring November 5 with his election as prime minister. Mr. Miyazawa's elevation to the government's top leadership position was expected in view of the LDP's majority in the lower house, which has the final say in the selection of the prime minister. Nevertheless, the special Diet session's action no doubt was a sweet victory for the seasoned politician as it brought to an end -- at least for the immediate future -- the intense, intraparty maneuvering for power and influence that ensued soon after outgoing Prime Minister Toshiki Kaifu announced in early October that he would not seek reelection (see JEI Report No. 39B, October 18, 1991). Mr. Miyazawa now can get on with the business of governing the country.

Many political observers question, however, whether the new prime minister, known for his political savvy and policy vision, can run his own show or

Penh to resolution of the Cambodian conflict, some government officials predict resumption of large-scale aid to Vietnam will hinge on action by the World Bank and the International Monetary Fund. Japan has directed limited aid and emergency relief to the region, granting Cambodia $1.9 million in 1989 and Vietnam $1.6 million that same year, the latest year for which data are available. This summer Tokyo announced it would provide emergency assistance worth Y15.8 million ($117,000 at Y135=$1.00) to the Cambodian Supreme National Council to assist victims of devastating floods that swept through that country in August. Now that the Cambodian peace settlement has been signed many in Japan and the international community will expect Tokyo to take a leading role in reestablishing the stability of this troubled corner of a politically and economically important region.

Margo Grimm

Japan's Deficit In Services With United States Up In 1990

In recent years some analysts have argued that Japan's advantage lies in "hardware," while the United States has a lead in "software." Certainly a number of high-profile acquisitions of U.S. companies by Japanese businesses in recent years appear to have reflected this belief, as exemplifed by the purchases of large U.S. movie studios by Sony Corp. and Matsushita Electric Industrial Co., Ltd. Statistics on bilateral trade also mirror the apparent competitiveness of each country in these two broad sectors, although only half the relationship has received wide publicity.

The U.S. trade deficit with Japan last year came to $41.7 billion on a balance of payments basis, but this figure actually measures only trade in goods (hardware). The data's software counterpart, trade in services, appears to be virtually unnoticed. As shown in the Table, the U.S. surplus in services trade with Japan came to $10.8 billion in 1990, offsetting roughly a quarter of the goods imbalance. (The table, which relies on Department of Commerce data, shows only those services that are not direct payments to labor or capital; as such it excludes interest and dividend payments, repatriated profits and wages.) Although the U.S. trade deficit with Japan shrank 16.1 percent in 1990, this country's bilateral surplus in services grew 3.4 percent. (For details of the 1989 U.S.-Japan services trade, see JEI Report No. 43B, November 9, 1990.)

As in the past, more than half the imbalance was accounted for by travel. This figure represents Japanese travelers' expenditures for food, lodging and other expenses during visits in the United States. Japanese travel expenditures in the United States increased 9.1 percent in 1990; comparable U.S. spending in Japan rose 14.9 percent, but the bilateral imbalance in this category grew as measured in dollars.

Even though travel is by far the largest services sector, it is among the least politically charged. Washington has a long list of complaints concerning Japanese trade practices, but it cannot credibly claim that Tokyo is forcing Japanese tourists to stay at home. Political fireworks have exploded, instead, around some of the other sectors. For example, data on royalties and license fees measure what sometimes is called "technical trade." Despite extensive handwringing in the United States about how Japanese firms are overtaking U.S. companies in technological sophistication, Japanese companies continue to pay American firms far more for technology than they receive in return. (See JEI Report No. 36A, September 27, 1991 for details of Japan's worldwide technology trade.) Furthermore, this imbalance, typically measured by royalties among unaffiliated firms, grew in dollar terms in 1990. U.S. receipts as a multiple of U.S. payments declined modestly, however. (Most experts regard with

U.S. Trade in Nonfactor Services with Japan, 1990

(in millions of dollars)

	Exports	Imports	Balance
Travel	$7,694	$2,151	$5,543
Passenger Fares	2,853	439	2,414
Freight	1,022	1,986	-964
Port Services and Other Transportation	2,186	2,197	-11
Royalties and License Fees			
Among Affiliated Firms	1,702	397	1,305
Among Unaffiliated Firms	1,205	184	1,021
Private Services Among Affiliated Firms			
Among Firms with Non-U.S. Ownership	1,010	450	560
Among Firms with U.S. Ownership	354	703	-349
Business, Professional and Technical Services Among Unaffiliated Firms	829	334	495
Advertising	40	100	-60
Computer and Data Processing	165	4	161
Database and Other Information Services	53	9	44
Research, Development and Testing Services	141	D	D
Management, Consulting and Public Relations Services	15	24	-9
Legal Services	112	6	106
Construction, Engineering, Architectural and Mining Services	33	72	-39
Industrial Engineering	69	3	66
Installation, Maintenance and Repair of Equipment	137	23	114
Other	65	D	D
Other Private Services Among Unaffiliated Firms			
Education	404	15	389
Financial Services	468	650	-182
Insurance	583	156	427
Telecommunications	220	304	-84
Other	222	35	187
Total Nonfactor Services	20,752	10,001	10,751

D = suppressed to avoid disclosure of data on individual companies.

Source: Department of Commerce, Bureau of Economic Analysis skepticism the statistics on trade among affiliated firms, such as that between a Japanese company operating in the United States and its parent, because that data may reflect corporate accounting procedures rather than actual technology flows.)

Some of the services sectors over which the noisiest disagreements arise between the United States and Japan are shown in the table to involve relatively little trade. For example, legal services has been the subject of past complaints about barriers to U.S. law firms setting up shop in Japan. As with many other business, professional and technical services, international legal services typically are performed on location using locally hired talent and resources. And these domestic transactions are not reflected in the trade statistics. On a trade basis, legal services generated only $112 million in U.S. exports in 1990, less than three days worth of Japanese car shipments to the United States. However, one quarter of worldwide U.S. exports of legal services went to Japan. (For details on foreign lawyers in Japan, see JEI Report No. 28A, July 26, 1991.)

Some experts believe that services are more likely to be traded directly in the future. For example, skilled physicians may be able to use sophisticated communications technologies to provide their services across international boundaries. Should such practices become widespread, global trade in services could explode. Services have represented a larger share of U.S. economic activity than manufacturing for decades; this sector also is a significantly larger factor in the Japanese economy than goods production. Although services trade could hold a comparable position to international trade in goods some day, the services sector currently contributes far less to the external balance. In this regard, few should be surprised that, despite America's apparent advantage in services, when both goods and services are counted the U.S. trade data with Japan still weighs heavily in Japan's favor.

Douglas Ostrom

Competition Spurs Intellectual Property Concerns

Disputes over intellectual property rights have become a common feature of U.S.-Japan trade relations; increasingly they are erupting between Japanese firms. This trend reflects several factors, including: intensifying competition between Japanese and American companies in their home markets as well as globally; the growing efforts of medium-sized American and Japanese firms to penetrate foreign markets; the critical importance of intellectual property assets in the high technology, music and arts industries; and evolving Japanese views toward intellectual property rights. At the urging of domestic interests and Washington, Tokyo gradually is moving to update and strengthen its rules on patents, trademarks, copyrights and trade secrets.

Patents - The Japanese patent system has come under heavy criticism from Washington and other foreign governments for not providing what they consider adequate protection. The two principal U.S. complaints are: Japan's "first-to-file" system is not as favorable toward inventors as the American "first-to-invent" system, and the Japanese system does not provide effective protection while a patent is being processed nor after it is granted. (For an analysis of intellectual property rights in Japan, see JEI Report No. 8A, February 24,

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Cancellation Of Bush's Asian Trip Stirs Washington, Tokyo Reactions

When the White House announced November 5 that President Bush's late November trip to Japan and other Asian countries had been canceled, the chief executive may have created more public relations problems than he had hoped to solve by curtailing his foreign travel. In the domestic arena some political commentators and members of the president's own party criticized the decision as a precipitate response to Democratic charges that Mr. Bush focuses on foreign policy at the expense of domestic issues. Despite White House denials, cancellation of the Asian tour had a particular political cast because it was announced the evening of an election day in which some key Republicans were defeated in state and local races.

Prime Minister Kiichi Miyazawa tactfully said that he understood why Mr. Bush could not visit Japan as planned, but statements by other Japanese officials suggest disappointment in Tokyo. Mr. Miyazawa viewed the president's visit as an important opportunity to develop a joint declaration of a global partnership between the United States and Japan in the post-Cold War era. The cancellation of Mr. Bush's trip obviously delays issuance of this important visit, Secretary of State Baker presented much of the message to Japan that the president presumably would have delivered. In a November 11 speech to the Tokyo-based Japan Institute for International Affairs Mr. Baker emphasized Washington's interest in the Asian Pacific region, saying, "America's fate is ever more closely tied to East Asia and the Pacific." In what was billed as the major speech of his week-long tour of the Asian region Mr. Baker also sought to assure his audience that, despite U.S. troop reductions in Japan and elsewhere in the region, the U.S. commitment to Japanese security remains "unshakable." In addition, the secretary of state used his address to nudge Japan toward greater assumption of global political responsibilities, urging Tokyo to go beyond "checkbook diplomacy," an apparent reference to Japan's provision primarily of money to support the coalition forces that fought in the Persian Gulf War.

Barbara Wanner

Japan's Balance Of Payments Surplus Rises Again

Japan's latest balance of payments statistics, released November 1, captured the gloominess of late autumn for those on either side of the Pacific who worry that the current account surplus, which fell by more than half between its 1987 peak and 1990, is again on the upswing. Compared to a year earlier, Japan's dollar-denominated current account surplus soared 161.5 percent in the July-September period (see Table 1). That represented the second straight quarter of a year-to-year surge after nine straight quarters of decline.

For Americans hoping for a smaller trade imbalance and struggling with a sluggish economic recovery, the news was not only depressing but surprising. One of the very few silver linings that a nation under a recessionary cloud can expect is either a smaller current account deficit or a larger surplus. Based on U.S. data through the second quarter the American current account deficit with Japan declined substantially over the past year. Although third-quarter data are not yet available on a bilateral basis, Japan's surging overall current account surplus for the period indicates that the U.S.-Japan imbalance probably has shown little additional movement despite weak import demand in the United States.

Japanese analysts have tended to interpret the latest balance of payments statistics as an inevitable reaction to unsustainable developments in 1990. This argument has two parts: one, as noted above, suggests that weak demand in the United States and other major export markets because of recession or slow growth last year reduced Japanese exports below the levels they otherwise would have reached. The other part is that Japan's imports in 1990 were abnormally high due to the now widely recognized financial "bubble;" that phenomenom led to inflated imports of luxury cars, paintings and other expensive goods. In short, this argument continues, no one should have expected Japan's balance of payments surplus in 1991 to have equaled 1990's level of $35.8 billion absent these special influences, which now have been reversed. This argument concludes with the observation that Japan's own economic growth rate in mid-1991 may have been below that of its trading partners, implying weak demand for imports and relatively buoyant export demand. This line of reasoning meshes neatly with recent estimates that Japan's current account surplus in 1991 is likely to exceed $60 billion, or approximately the 1989 level.

Table 1: Japan's Balance of Payments

(in millions of dollars)

	Trade Balance	Exports (f.o.b.)	Imports (f.o.b.)	Services (net)	Current Account Balance	Long-Term Capital (net)
1986	$92,827	$205,591	$112,764	$-4,932	$85,845	$-131,461
1987	96,386	224,605	128,219	-5,702	87,015	-136,532
1988	95,012	259,765	164,753	-11,263	79,631	-130,930
1989	76,917	269,570	192,653	-15,526	57,157	-89,246
1990	63,528	280,374	216,846	-22,292	35,761	-43,586
1989: I	21,311	66,945	45,634	-3,595	16,064	-5,612
II	19,794	66,560	46,766	-4,892	14,283	-30,801
III	19,770	68,157	48,387	-4,023	14,957	-21,559
IV	16,042	67,908	51,866	-3,016	11,853	-31,274
1990: I	14,393	65,460	51,067	-701	12,305	-16,086
II	13,614	65,510	51,896	-5,279	7,892	-18,985
III	17,149	70,500	53,351	-8,045	7,400	-7,247
IV	18,372	78,904	60,532	-8,267	8,164	-1,268
1991: I	20,729	74,978	54,249	-920	10,260	10,707
II	23,352	71,990	48,638	-4,064	18,664	-7,103
III(p)	33,836	76,931	43,095	-7,074	19,349	9,885

These factors appear to have gone unforeseen by the Economic Planning Agency last December when it developed its FY 1991 economic outlook. EPA projected a current account balance of only $30 billion for the fiscal year ending March 31, 1992. This figure would have been a drop from $33.7 billion in FY 1990. In the first half of FY 1991 alone the current account surplus exceeded $38 billion, putting EPA's original estimate in the impossible dream category.

Normally, a surging Japanese current account surplus at least brings with it the benefit in American eyes of a larger outbound capital flow. However, the latest figures appear to offer confirmation of just the reverse: net Japanese foreign investment in securities has dropped sharply since the late 1980s (see Table 2). Furthermore, capital flows into Japan from the United States and Europe have jumped dramatically. In September foreigners pumped a net $9.1 billion into the Japanese stock market, the largest monthly amount ever. Largely as a result of these and other securities transactions, long-term capital showed an unusually sharp net inflow in the July-September quarter (Table 1). Offsetting this inflow and the larger current account surplus were substantial reductions in the net overseas short-term liabilities of Japanese foreign exchange banks. Such activity arguably helps drive down foreign interest rates, while it avoids stoking resentment toward rising Japanese foreign investment.

Most experts expect Japan's annual current account surplus to stabilize around $60 billion. For example, the International Monetary Fund, which predicts that the current account surplus will reach $62.7 billion in 1991,

Table 2: Japan's Net International Long-Term Securities Transactions

(in millions of dollars)

	Net Japanese Purchases			Net Foreign Purchases			Net
	Bonds	Stocks	Other*	Bonds	Stocks	Other**	Outflow
1986	$-93,024	$-7,048	$-1,905	$-2,109	$-15,758	$18,412	$-101,432
1987	-72,885	-16,874	2,002	6,675	-42,835	30,079	-93,838
1988	-85,812	-2,993	1,856	-21,628	6,810	35,116	-66,651
1989	-94,083	-17,887	-1,208	2,400	6,998	75,746	-28,034
1990	-28,961	-6,256	-4,464	16,991	-13,276	30,938	-5,028
1989: I	-14,003	104	577	-1,646	9,004	16,212	10,248
II	-25,091	-6,108	-776	-587	-6,196	27,501	-11,257
III	-25,871	-4,795	722	5,403	757	14,123	-9,661
IV	-29,118	-7,088	-1,731	-770	3,433	17,910	-17,364
1990: I	-869	-4,946	717	6,182	-11,713	8,246	-2,383
II	-9,353	-2,153	-954	4,975	838	723	-5,924
III	-10,905	-459	-2,405	4,790	-3,380	10,485	-1,874
IV	-7,834	1,302	-1,822	1,044	979	11,484	5,153
1991: I	-13,356	463	-1,348	1,418	17,486	9,129	13,792
II	-22,423	-2,840	-1,353	6,348	4,140	11,778	-4,350
III(p)	-11,120	-134	-94	9,509	15,245	13,317	26,723

*Yen-denominated bonds issued in Japan.
**Bonds issued outside of Japan by Japanese institutions.

Note: For outflows a minus sign indicates an increase in assets abroad. For inflows a positive value indicates an increase in Japanese liabilities to foreigners.

forecasts that the imbalance will fall slightly to $59.4 billion in 1992. These projections, of course, make assumptions about budget policy and investment intentions in Japan, the United States and elsewhere. Should Japan's economic malaise be deemed serious enough to warrant fiscal stimulation larger than now anticipated, increased demand on domestic capital markets would increase the yen's value, depress exports and lead to a smaller current account surplus.

Douglas Ostrom

Interest Rate Deregulation Hits Bumps

After several years in which Tokyo's plan to deregulate and reform domestic financial markets made significant strides, a major stumbling block has arisen for one of the most important parts of the plan -- replacing the rigid structure of government-determined interest rates paid on deposits with a system of market-determined ones. Interest rate deregulation has proceeded to the stage at which midsized and small financial institutions are being forced to undergo the inherently painful process of restructuring. Liberalization of interest rates will not be finished, however, without a definition of the role of

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JAPAN'S FOREIGN AID PROGRAM: 1991 UPDATE

Summary

In recent years the Japanese government has acknowledged the challenges to its foreign aid program presented by global expectations and demands. The Persian Gulf crisis provided Tokyo a dramatic impetus to give greater shape to the bolder political role for Japan's aid program hinted at last year. The new aid guidelines, which call on the government to weigh recipient nations' policies in certain areas, are seen by some observers as a step toward clearer articulation of the principles guiding Japanese development assistance.

Tokyo has made progress toward the general targets set in 1988 for improving both the quantity and the quality of its official development assistance, providing over $9 billion in grants and loans in 1990. Yet a number of aid experts believe that the Japanese aid program has not yet taken on the focus or the responsibilities implicit in Japan's role as one of the world's largest ODA donors. The difficulties of carrying out stated goals and effectively implementing development projects remain. Moreover, evolving international demands and domestic pressures are forcing donor nations, including Japan, to reexamine their definitions of aid and what they hope to achieve through economic assistance to developing countries.

1990 Aid Comparisons

Outlays of more than $9 billion in official development assistance in 1990 again ranked Japan as one of the largest donors of foreign aid among the

18 nations participating in the Development Assistance Committee of the Organization for Economic Cooperation and Development (see Table 1). The United States ended Japan's one-year reign as the top donor of foreign aid among DAC members with net disbursements of $11.4 billion, the Paris-based OECD announced this past October.[1] Japan and the United States have vied for the number-one spot for several years, and aid experts anticipate further switches in the top slot in the future.

In both yen and real terms Japan's foreign aid disbursements have been on the rise in recent years. Total ODA outlays as figured by the OECD increased 6.2 percent on a yen basis in 1990 and 4.2 percent after adjustment for changes in prices and in the yen-dollar exchange rate. Bilateral assistance rose 3 percent in real terms last year, while disbursements to multilateral institutions increased 8 percent, the OECD reported. When disbursements to Eastern European nations (not considered developing countries by the OECD and therefore omitted from DAC statistics) are included, Japan's 1990 aid expenditures totaled $9.2 billion. Assistance to individual countries, including Eastern Europe, amounted to $6.9 billion, an increase of 2.4 percent; money channeled through multilateral institutions came to $2.3 billion, a gain of 4.4 percent. Overall, net disbursements on a DAC basis rose 1.2 percent in dollar terms in 1990.

Based on the size of last year's increase, many observers question whether Japan will be able to meet its target of disbursing $50 billion in foreign aid over the 1988-92 period unless the yen appreciates significantly against the dollar. According to Japanese government calculations, OLA disbursements between 1988 and 1990 totaled $27.3 billion, leaving roughly 45 percent of the target to be met in the final two years of the fourth medium-term plan.

Related to its goal of an expanded volume of aid is Tokyo's endeavor to increase economic assistance as a percentage of the nation's gross national product. Foreign aid as a share of GNP for the 18 DAC members combined was 0.35 percent in 1990, only slightly higher than the comparatively low 1989 level of 0.34 percent. Japan's figure of 0.31 percent, however, was unchanged (see Table 2). As in 1989, Japan ranked 12th among DAC members on this scale; the U.S. ratio of 0.21 placed it next to last. Japan and the United States have made little, if any, progress in boosting foreign aid as a percentage of GNP since 1987, when they took over the two top spots in terms of net disbursements.

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[1] Currency fluctuations and the timing of contributions to multilateral institutions, often a factor in the records of DAC members' foreign aid efforts, are particularly important to consider when comparing the aid programs of Japan and the United States. U.S. payments to multilateral institutions, made in line with fiscal year appropriations, at times have been concentrated outside the calendar year the OECD uses to record foreign aid statistics. In 1989, for example, the OECD recorded particularly low U.S. contributions, clearing the way for Japan to assume the number-one donor position. Conversely, U.S. contributions to multilateral organizations made up a large part of the 48.1 percent jump in this country's 1990 foreign aid.

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Table 1: ODA of Major Donor Countries, 1986-90

(in millions of dollars; net disbursements)

1990 Rank	Country	1986	1987	1988	1989	1990*	Share of Total DAC ODA 1990*
1	United States	$9,564	$8,945	$10,141	$7,676	$11,366	21.0%
2	Japan	5,634	7,342	9,134	8,965	9,069	16.8
3	France**	3,403	4,489	4,777	5,162	6,571	12.2
4	Germany	3,832	4,391	4,731	4,948	6,320	11.7
5	Italy	2,404	2,615	3,193	3,613	3,395	6.3
6	United Kingdom	1,737	1,871	2,645	2,598	2,647	4.9
7	Canada	1,695	1,885	2,347	2,320	2,470	4.6
DAC Total***		36,663	41,426	48,132	46,723	54,077	100.0

*Preliminary.
**Excluding overseas departments and territories.
***1990 total includes France's overseas departments and territories but does not include disputed amounts.

Source: Organization for Economic Cooperation and Development

Table 2: ODA as Percentage of GNP for DAC Countries, 1986-90

(in millions of dollars; net disbursements)

1990 Rank		1986		1987		1988		1989		1990*		Percent Change 1989-90*
		Amount	Percent of GNP	Amount	Percent of GNP	Amount	Percent of GNP	Amount	Percent of GNP	Amount	Percent of GNP	
1	Norway	$798	1.20%	$890	1.09%	$985	1.13%	$917	1.05%	$1,207	1.17%	31.5%
2	Netherlands	1,740	1.01	2,094	0.98	2,231	0.98	2,094	0.94	2,592	0.94	23.8
3	Denmark	695	0.89	859	0.88	922	0.89	937	0.93	1,171	0.93	25.0
4	Sweden	1,090	0.85	1,375	0.88	1,534	0.86	1,799	0.96	2,012	0.90	11.8
5	Finland	313	0.45	433	0.49	608	0.59	706	0.63	846	0.64	19.8
6	France**	3,403	0.48	4,489	0.51	4,777	0.50	5,162	0.54	6,571	0.55	27.3
7	Belgium	547	0.48	687	0.48	618	0.39	703	0.46	891	0.45	26.6
8	Canada	1,695	0.48	1,885	0.47	2,347	0.50	2,320	0.44	2,470	0.44	6.5
9	Germany	3,832	0.43	4,391	0.39	4,731	0.39	4,948	0.41	6,320	0.42	27.7
10	Australia	752	0.47	627	0.34	1,101	0.46	1,020	0.38	955	0.34	-6.3
11	Italy	2,404	0.40	2,615	0.35	3,193	0.39	3,613	0.42	3,395	0.32	-6.0
12	Japan	5,634	0.29	7,342	0.31	9,134	0.32	8,965	0.31	9,069	0.31	1.2
13	Switzerland	422	0.30	547	0.31	617	0.32	558	0.30	750	0.31	34.5
14	United Kingdom	1,737	0.31	1,871	0.28	2,645	0.32	2,598	0.31	2,647	0.27	1.9
15	Austria	198	0.21	201	0.17	301	0.24	282	0.23	389	0.25	37.7
16	New Zealand	75	0.30	87	0.26	104	0.27	87	0.22	93	0.22	6.7
17	United States	9,564	0.23	8,945	0.20	10,141	0.21	7,676	0.15	11,366	0.21	48.1
18	Ireland	62	0.28	51	0.19	57	0.20	49	0.17	57	0.16	16.3
DAC Total***		36,663	0.35	41,426	0.34	48,132	0.36	46,723	0.34	54,077	0.35	15.7

*Preliminary.
**Excluding overseas departments and territories.
***1990 total includes France's overseas departments and territories but does not include disputed amounts.

Source: Organization for Economic Cooperation and Development

Japan's 1990 Aid Efforts

In a summary of its 1991 report on official development assistance the Ministry of Foreign Affairs acknowledged that Japan's foreign aid contribution is still low "when measured according to recognized international criteria." Those yardsticks include not just the ratio of aid to GNP, the principal measure of the amount of aid disbursed by donor nations, but also indicators of the quality of economic assistance -- notably, the share of aid given as grants and the grant element of loans, a measure of concessionality that weighs the interest charged, the length of the loan and the grace period.

During the 1988-89 period Japan ranked last among DAC members in terms of the share of grants in its total ODA commitments. Its two-year average of 42.4 percent was far below the all-DAC figure of 75.6 percent; the Japanese ratio also represented a drop from the 1987 level of 46.6 percent. The grant element or "softness" of Japanese loans averaged out to 57.2 percent in the 1988-89 time frame. Here, Japan's average was closer to that of other DAC members in the 1988-89 period (57.4 percent overall).

Although the international donor community generally considers grants to be higher quality development assistance than loans, Japan's aid philosophy that recipient nations should work toward economic self-sufficiency biases the program toward loans, which instill the discipline of repayment. While both loans and grants increased in 1990, more of Japan's bilateral ODA consisted of loans last year than in the previous year, 56.5 percent compared to 55.2 percent (see Table 3). In dipping from 44.8 percent in 1989 to 43.5 percent in 1990, grants as a share of bilateral aid returned to the 1983-87 average.

The 1988-92 foreign aid plan calls for Japan to expand the amount of aid given in grant form, particularly to the least developed countries. The Foreign Ministry's 1991 aid review indicated that grants as a share of bilateral aid to the least developed countries increased last year to 66.2 percent, up from 64.7 percent in 1989. Calls for continued efforts in this area found support in the report, which indicated that funds for grants were being expanded and that more money would be earmarked for nonproject-type grants and small-scale project grants. However, the Foreign Ministry report also hinted that loans will continue to be an important element in Japan's economic assistance: "There should be greater recognition of the utility of ODA loans. Grant aid should be provided primarily to the less-developed countries."

Japan continued to make progress in 1990 on another measure of aid quality, the percentage of assistance allocated to basic human needs. Last year 34.3 percent of Japan's bilateral aid went to support basic human needs -- defined as assistance for social infrastructure and services, agriculture, food aid and emergency needs -- up from 28.2 in 1989. Although in recent years Tokyo has scaled down significantly the proportion of its bilateral aid directed to economic infrastructure projects, such as transportation networks and power plants, aid for this purpose dropped marginally in 1990 to 31.5 percent from 31.7 percent.

Disputes Over Tied Aid

In 1990 the Japanese government continued to address recurring criticism from abroad that its foreign aid program is intertwined too closely with Japanese private-sector interests. Many aid experts acknowledge that Tokyo has made

Table 3: Net Flow of Financial Resources from Japan to Developing Countries and Multilateral Agencies, 1986-90*

(in millions of dollars; net disbursements)

Type of Transaction	1986	1987	1988	1989	1990	Percent Change 1989-90
Official Development Assistance	$5,634	$7,454	$9,134	$8,965	$9,222	2.9%
Change Over Previous Year	48.4%	32.3%	22.5%	-1.9%	2.9%	
ODA/GNP Ratio	0.29%	0.31%	0.32%	0.31%	0.31%	
Bilateral Assistance	3,846	5,248	6,422	6,779	6,940	2.4%
Grants	1,703	2,221	2,908	3,037	3,019	-0.6%
Grant Assistance	855	1,154	1,483	1,556	1,374	-11.7%
Technical Assistance	849	1,067	1,425	1,481	1,645	11.1%
Development Lending and Capital	2,143	3,027	3,514	3,741	3,920	4.8%
Grants, Capital Subscription and Loans to Multilateral Agencies	1,788	2,207	2,712	2,186	2,282	4.4%
Addendum:						
ODA in Yen Terms (billions)	Y950	Y1,078	Y1,171	Y1,237	Y1,335	7.9%
Change Over Previous Year	4.8%	13.5%	8.6%	5.7%	7.9%	

*Includes ODA to Eastern Europe

Source: Ministry of Foreign Affairs

significant progress in moving away from its past tendency to tie aid to the purchase of goods and services from Japanese firms. In the mid-1980s almost half of Japan's ODA loans were tied. By 1988, the government calculated, the untied portion of total bilateral ODA was 72.8 percent; that figure, it said, contrasted favorably with its estimate that 21.6 percent of U.S. bilateral aid was untied that year. (The OECD came up with different numbers for the untied portion of Japanese and American bilateral ODA in 1988, but the statistics are of the same order of magnitude.) By last year the share of Japan's ODA loans that was untied had climbed to 84.4 percent, up 3.9 percentage points from 1989's figure, the Foreign Ministry reported.

Part of the dispute over tied aid stems from definitional differences. Ernest Preeg of the Washington-based Center for Strategic and International Studies contends that Japanese figures on untied aid are overstated because Tokyo reports as untied those projects in which the engineering work must go to Japanese companies. This contradicts an agreement among DAC members that projects are to be considered tied if any money must be spent in the donor's country, he adds.[2] Some aid experts also argue that the nature of Japan's aid system results in de facto tying. They point out that Tokyo's "request-only" aid policy works to the advantage of Japanese contractors and that Japanese interests are at times behind the in-country firms that win aid-funded projects.

Addressing this criticism, Tokyo has estimated that the percentage of loan-funded procurements that went to Japanese businesses was only 27 percent in 1990 compared to a 1986 peak of 67 percent. Robert Orr, director of the Kyoto Center for Japanese Studies and Stanford Center for Technology and Innovation, has pointed out that the appreciation of the yen since 1985 and Japan's increased emphasis on program loans, combined with government attention to broadening the scope of its foreign aid, have tended to unhook procurement.[3] "Through such efforts," the 1991 Foreign Ministry foreign aid report concluded, "criticism that Japanese aid comes with strings attached will no longer apply."

Criticism is unlikely to abate, however, since some aid experts and representatives of donor nations continue to argue that Tokyo's statistics are not an accurate reflection of which country's private sector benefits from business opportunities created by Japanese aid. Moves to address the tied aid debate in the multilateral arena and in Washington reveal the divisiveness of the issue.

International Efforts - After years of talking about ways to limit the use of tied aid, OECD members tentatively agreed in late October to a new regulatory framework. The rules prohibit donor nations from providing tied aid to higher-income developing nations, such as Brazil, Mexico and Venezuela, and constrain the use of this practice for certain projects in middle-income recipient nations. Donors will be allowed to tie aid going to the least developed countries, however. The arrangement does not cover grants, food aid and humanitarian assistance. It also does not apply to the countries of Eastern and Central Europe, although OECD countries previously had agreed to make their "best effort" not to tie aid in this part of the world. Barring objection from any OECD member, the agreement is slated to take effect December 16. Some observers are skeptical that the guidelines will dissuade donor nations, including Japan, from practices that result in aid-funded business going to domestic firms.

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[2] Ernest H. Preeg, "Comment" in Shafiqul Islam (ed.), Yen for Development: Japanese Foreign Aid and the Politics of Burdensharing (New York, New York: Council on Foreign Relations Press, 1991), p. 115.

[3] Robert M. Orr, Jr., "Japanese Foreign Aid in a New Global Era," SAIS Review, Summer/Fall 1991, p. 138.

Washington's Actions - The OECD negotiations are part of a long battle by Washington to win reductions in the use of tied aid, which the White House regards as trade-distorting. Capitol Hill also has targeted the practice, most recently in a provision included in the foreign assistance authorization bill aimed at directing more of the benefits of U.S. foreign aid to American businesses. Lawmakers meeting to reconcile the House and the Senate versions of the bill in mid-September recommended that during the FY 1992-FY 1993 period the Agency for International Development funnel $1.35 billion of U.S. aid into capital projects tied largely to the use or the purchase of American goods and services.

The compromise significantly narrowed an amendment offered by Sen. David Boren (D, Okla.), which was based on the Aid for Trade Act he introduced in March with the support of Democratic colleagues Sens. Lloyd Bentsen (Texas), Robert Byrd (W.Va.) and Montana's Max Baucus (see JEI Report No. 30B, August 9, 1991). Although the conference committee dropped the mandates and the restrictions in the original amendment to the Senate bill, the provision's supporters were said to be satisfied that the compromise version recommends higher levels of funding than currently directed toward capital projects. Also retained in the compromise measure was a separate provision that links cash transfers disbursed through the economic support fund program (a category of aid extended to countries of special strategic significance to the United States) to the purchase of U.S. goods and services and the use of American-flagged vessels.

The Bush administration, which has expressed opposition to such provisions as the requirement on cash transfers, will not get a chance to act on the compromise measure. After Senate passage of the two-year, $25 billion foreign aid authorization bill in early October, the House rejected the bill late that month. The action reflected both congressional concern about the U.S. economy and the majority party's charges that the Bush administration is ignoring domestic problems. This issue is likely to resurface when Congress considers a foreign aid appropriations bill, an action possible under a congressional waiver of the requirement that a measure win authorization before it is funded. The Senate Committee on Appropriations is the probable venue for the next round of foreign aid discussions. Since Sen. Byrd heads that committee and is one of the original sponsors of the Aid for Trade Act, congressional observers believe that the capital projects provision has a solid chance of surviving the appropriations process.

Supporters of the aid for trade measure contend that its primary purpose is not to retaliate against the tied-aid practices of other countries but to provide better balance in this country's foreign aid program. In a late October letter to Secretary of State James Baker, Sens. Boren, Baucus and Joseph Lieberman (D, Conn.) urged: "We must look to new ways to mobilize the private sector and make it a more active partner with the federal government in attaining U.S. foreign policy and economic development objectives." The Democratic senators added, "It is time to take a hard look at our foreign policy objectives and insure that they support enhancement of U.S. global economic leadership."[4]

Calls to give American business a bigger role in the U.S. aid program reflect anxieties about slipping U.S. global competitiveness and contrast with the comments from some of the same groups about the tied-aid component of Japan's program. Yet even policymakers and legislators wary of using American economic assistance to further U.S. commercial interests see problems ahead for the U.S. foreign aid program. In light of waning public support, constraints on the domestic budget and rapidly changing international demands, America's aid program faces a reevaluation. That review makes it likely that Washington will continue to press Japan to do more in the foreign aid field.

Growing Worldwide Demand for Aid

Japan frequently is cited as the only nation with adequate resources to address the growing demand around the world for more development assistance. The Foreign Ministry's 1991 aid review acknowledged, "It is becoming increasingly difficult to satisfy world demand for resources, and Japan has become the focus of rising expectations." In striving to help meet this demand, the report noted, the Japanese government will continue to give priority to Asia but will extend aid in line with the development needs of other regions.

Last year Japan's bilateral assistance to Asia dropped below 60 percent of the total for the first time (see Table 4). Even within Asia, however, the distribution of Japanese aid has been criticized. Some in the international donor community have called on Japan to increase its assistance to the poorer areas of the region. In 1989, for example, Southwest Asia (India, Pakistan, Nepal, Bangladesh, Bhutan, the Maldives and Sri Lanka) received 16.1 percent of Japan's bilateral ODA, compared to the 32.8 percent disbursed to more developed Southeast Asia. That same year, however, Japan was the largest aid donor to India, Bangladesh, Sri Lanka, Bhutan and the Maldives.

Despite the ongoing emphasis on Asia, shifts in the regional distribution of Japan's country-specific aid in 1990 reflected global developments that year. Aid to the Middle East returned to a level slightly above that of 1987. Disbursements jumped to 10.2 percent of all Japan's country-specific aid last year, closer to the Middle East's usual share in the second half of the 1980s after 1989's low level of 5.4 percent. That drop partly reflected Japan's decision to block new commitments to Egypt, one of its top past aid recipients in the region, due to Cairo's failure to repay debts owed to Tokyo. After Iraq invaded Kuwait in August 1990, however, Japan pledged $2 billion in economic aid to countries on the front line of Iraqi action, including Egypt, Jordan and Turkey (see JEI Report No. 1B, January 11, 1991). Although most of this assistance will show up as 1991 ODA disbursements, part of the Persian Gulf contribution was disbursed in 1990 and accounted for some of the increased share of bilateral ODA received by the Middle East last year.

Moreover, Eastern Europe received significantly larger amounts of aid than it ever had before; economic assistance totaling $153 million moved

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[4] Letter sent by Sens. Max Baucus, David Boren and Joseph Lieberman to Secretary of State James Baker, October 30, 1991.

Table 4: Japan's Bilateral ODA by Region, 1986-90

(in millions of dollars; net disbursements)

Year	Total	Asia	Middle East	Africa	Latin America	Europe	Oceania	Unallocated
1986	$3,846 (100.0%)	$2,494 (64.8%)	$340 (8.8%)	$418 (10.9%)	$317 (8.2%)	$2 (0.1%)	$55 (1.4%)	$221 (5.7%)
1987	$5,248 (100.0%)	$3,416 (65.1%)	$526 (10.0%)	$516 (9.8%)	$418 (8.0%)	$2 (0.0%)	$68 (1.3%)	$302 (5.8%)
1988	$6,422 (100.0%)	$4,034 (62.8%)	$583 (9.1%)	$884 (13.8%)	$399 (6.2%)	$4 (0.1%)	$93 (1.4%)	$425 (6.6%)
1989	$6,779 (100.0%)	$4,240 (62.5%)	$368 (5.4%)	$1,040 (15.3%)	$563 (8.3%)	$11 (0.2%)	$98 (1.4%)	$458 (6.8%)
1990	$6,940 (100.0%)	$4,117 (59.3%)	$705 (10.2%)	$792 (11.4%)	$561 (8.1%)	$158 (2.3%)	$114 (1.6%)	$494 (7.3%)

Source: Ministry of Foreign Affairs

Table 5: Major Recipients of Japan's ODA, 1986-90

(in millions of dollars; net disbursements)

1986		1987		1988		1989		1990	
Country	Amount	Country	Amount	Country	Amount	Country	Amount	Country	Amount
China	$497	Indonesia	$707	Indonesia	$985	Indonesia	$1,145	Indonesia	$868
Philippines	438	China	553	China	674	China	832	China	723
Thailand	260	Philippines	379	Philippines	535	Thailand	489	Philippines	647
Bangladesh	248	Bangladesh	334	Thailand	361	Philippines	404	Thailand	419
Burma	244	India	304	Bangladesh	342	Bangladesh	371	Bangladesh	374
India	227	Thailand	302	Pakistan	302	India	257	Malaysia	373
Indonesia	161	Malaysia	276	Myanmar/Burma	260	Sri Lanka	185	Turkey	324
Pakistan	152	Burma	172	Sri Lanka	200	Pakistan	177	Pakistan	194
Sri Lanka	127	Turkey	162	India	180	Nigeria	166	Sri Lanka	176
Egypt	126	Pakistan	127	Egypt	173	Kenya	148	Poland	149

Source: Ministry of Foreign Affairs

Eastern Europe's share of Japan's bilateral aid from the nearly negligible range to 2.3 percent in 1990. Nearly all of this help went to Poland: disbursements of nearly $150 million made that country the tenth largest recipient of Japanese bilateral ODA in 1990 (see Table 5). These outlays reflect Japan's recent efforts to support economic and political reforms under way in Eastern Europe. In early 1990 Tokyo pledged nearly $2 billion in financial and technical assistance for Poland and Hungary (see JEI Report No. 3A, January 19, 1990); this package followed a late 1989 promise of $200 million in ODA to help the two East European nations move toward a market-driven economy.

Elsewhere, aid to Africa, on the upswing in both absolute and relative terms in the late 1980s, reversed course in 1990. Neither Nigeria nor Kenya made it onto the list of top recipients of Japan's foreign aid, although in 1989 the two had held the ninth and the tenth places, respectively. Latin America also received a slightly smaller portion of Japan's bilateral assistance last year, 8.1 percent compared to 8.3 percent in 1989, although the dollar amount was about the same in both periods.

Despite a cutback of nearly one-fourth last year to $868 million, Indonesia still managed to hold onto its ranking as the top recipient of Japan's bilateral economic assistance for the fourth year in a row (Table 5). With disbursements of $723 million, China, too, retained the position held for the previous three years of being the second-largest recipient of bilateral ODA. The Philippines, which received $647 million in aid in 1990, returned to its long-held position as one of the top three recipients of Japanese development assistance, switching places once more with Thailand.

Japan's Response to Changing Demands

Various aid initiatives and statements from the Foreign Ministry have hinted that Japan's program of economic assistance might assume a more political role (see JEI Report No. 47A, December 14, 1990). Japan traditionally has hesitated to impose political or economic conditions on aid recipients, chosen for assistance mainly for "humanitarian considerations and [in] recognition of interdependence in the international community." As a result, Tokyo has been criticized for failing to lead through its foreign aid efforts despite its weighty ODA expenditures. This year, however, Japan's foreign aid policy showed signs that international politics were a new factor in the decisionmaking equation.

The summary of the Foreign Ministry's 1991 aid review described interdependence, as encompassed in its aid philosophy, as a variable "to be determined by [the] changing international situation and Japan's position in the international community." The report emphasized that the Japanese government would boost its efforts to resolve growing international problems related to the environment, overpopulation and drugs and to increase support for the defeat of poverty. It also pointed out that certain aid initiatives undertaken by Tokyo in 1991 reflected the increasing responsiveness of Japan's aid policies to international political developments. Responses to the Persian Gulf crisis, for example, included refugee relief and reconstruction assistance in addition to aid to the neighboring countries most affected by the war.

Other politically linked aid initiatives included Tokyo's decision to expand its commitment to support economic reform in Eastern Europe. In April Japan agreed to provide approximately Y850 million ($6.3 million at Y135=$1.00) to establish a fund for Eastern Europe within the European Bank for Reconstruction and Development (see JEI Report No. 16B, April 26, 1991). The Japanese government also has promised to provide additional funding for Hungary as well as loans for Czechoslovakia and Romania to support these countries' moves to more market-oriented economic systems. In addition, Tokyo has put aside its previous reluctance to extend large-scale aid to the Soviet Union, announcing a $2.5 billion package of export insurance and economic assistance in early October (see JEI Report No. 39B, October 18, 1991). In a response to the continued internal conflict in Yugoslavia, Tokyo announced in mid-November the suspension of technical cooperation to Belgrade and a hold on studies related to the provision of official loans.

The Case for New Foreign Aid Principles

The Foreign Ministry's 1991 ODA report noted that the Persian Gulf War and the dramatic political reforms in Central and Eastern Europe as well as the Soviet Union "have led to the emergence of a national consensus in Japan that this country's aid should play a more active role in the achievement of world peace, stability, and democratization." This consensus, it was added, is reflected in new foreign aid guidelines announced in April by then Prime Minister Toshiki Kaifu (see JEI Report No. 16B, April 26, 1991). The guidelines call on the Japanese government to take into consideration both the military and the political policies of a recipient nation before providing aid. In particular, the guidelines say, aid administrators should look at a country's military expenditures; its development and production of weapons of mass destruction, including nuclear weapons; its weapons trade; and the promotion of democracy, efforts to institute market-oriented economies and human rights safeguards.

In recent months both the World Bank and the International Monetary Fund have said that they will take military expenditures into consideration before making loans and grants to a country, underscoring their position that excessive military spending diverts scarce resources from education, health and other areas fundamental to a nation's growth and economic security. While this emphasis is new for the World Bank and the IMF, the dilemma of balancing military and social spending is not. Heated international debate on the topic in the 1960s and 1970s concluded only that both donor and recipient nations should commit fewer resources to military spending. Japan's new guidelines on military expenditures and other policy issues are unique in part because of the context in which they were developed.

The Persian Gulf War acted somewhat as a catalyst, underscoring for Tokyo the problem of arms proliferation. During the 1980-88 war between Iran and Iraq, Japan had continued economic assistance to both. After Iraq's 1990 invasion of Kuwait, Tokyo was disturbed to realize the extent to which Iraq had directed resources -- presumably including foreign aid -- for military spending, according to one Japanese official. By presenting its new foreign aid guidelines within months of the Persian Gulf cease-fire, Tokyo emphasized not only its willingness to take a greater international political lead by advocating arms control but also its concern about arms proliferation. Since the guidelines were unveiled with less of the development and the planning that usually pave the way for the announcement of new policies, the effort also may have been aimed at offsetting the image that Japan was reluctant to act on a matter of global concern, one of the criticisms leveled against the country during the Persian Gulf crisis.

Japanese diplomats acknowledge that the principles need refining and that questions regarding their implementation remain. Discussions among donor nations as well as public debate and government-funded study are expected to further shape the guidelines, which have the backing of the ruling Liberal Democratic Party as well as the opposition parties and a public willing for Japan to take the lead in addressing the problem of massive international military spending.

Nations that receive foreign aid from Japan will find their policies scrutinized in the areas encompassed by the guidelines. The Japanese government reportedly would prefer to emphasize positive steps recipient nations take in response to the guidelines. For example, Tokyo might extend additional economic assistance to countries that reduce military spending rather than punish those that violate any of the four points.

Putting New Principles to the Test - The September overthrow of Haiti's democratic government headed by President Jean-Bertrand Aristide resulted in the first application of the guidelines. Tokyo's ban on both ongoing and new commitments to Haiti was in contrast to the approach it took in response to human rights violations in Myanmar (formerly known as Burma) in 1989. At that time Tokyo temporarily blocked economic assistance but resumed ongoing projects and continued such assistance despite the refusal of that country's military leaders to transfer power to the winning opposition party following elections in May 1990. Japanese observers suggest that the new guidelines steered Tokyo toward harsher measures for Haiti.

Other times when Japan has raised the threat of its new guidelines include an August meeting between China's Premier Li Peng and then Prime Minister Kaifu, who reportedly mentioned the guidelines in his request that Beijing adhere to the Nuclear Nonproliferation Treaty and restrict military expenditures and arms exports. The Japanese government also is reported to have cited the principles when urging Pakistan to sign the Nuclear Nonproliferation Treaty this spring.

As the leading donor of bilateral aid to dozens of countries (26 in 1988) Japan certainly has the economic strength to influence the policies of recipient nations. Yet some analysts believe it will be difficult for Tokyo to implement the guidelines consistently and effectively. China, a major arms exporter and the second-largest recipient of Japan's bilateral ODA for the last four years, is most frequently cited as presenting such a dilemma. Japan sees aid to that country as a crucial stabilizing factor. Foreign Ministry spokesman Taizo Watanabe indicated in a July press conference that Tokyo had broached the new principles with Beijing and to date had "no problems with our continued aid policy toward China." The new policy, Mr. Watanabe stressed, "is not a constitution or a very strict law. It is our principle, and we are trying to apply it on a case-by-case basis, based on our determination to promote peace and stability in the world."[5]

Stanford Japan Center's Orr points out that in cases like China and Myanmar the guidelines conflict with Japan's security interests. He speculates that Tokyo will have to apply the guidelines selectively but notes that since this is the first time Tokyo has articulated any kind of political position in its foreign aid program the guidelines do reflect change.[6] He cautions, though, that it is too early to predict their impact, particularly since the principles reflect the objectives of the Foreign Ministry, the lead agency on aid but only one of four government organizations dealing with economic assistance.[7] (The Ministries of Finance and International Trade and Industry plus the Economic Planning Agency also share various administrative responsibilities relating to ODA.)

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[5] Press conference by Taizo Watanabe, press secretary/director general for public information, Ministry of Foreign Affairs, July 23, 1991.

John Sewell, president of the Washington-based Overseas Development Council, suggests that Tokyo will invite criticism if it appears to be temporizing on the new principles. The guidelines are a "good example of Japan showing leadership," he notes, "but leadership has to be applied consistently."[8]

Amid the cautions about the new guidelines are criticisms from both recipient nations and Japanese observers who question the direction of the new program. One concern is that the guidelines will interfere with recipients' sovereignty. Another is that increasing the strategic element of Japanese aid will undermine the extent to which economic assistance can meet developing countries' needs.

While most Japanese support economic assistance as a tangible means of expressing Japan's commitment to the international community, arguments persist about how best to implement the country's aid program, according to one Japanese diplomat. In its recent report on ODA the Foreign Ministry indicated that it wants to further a national consensus on aid, which it termed essential to achieving economic assistance objectives. "Educating people about assistance for developing countries is an urgent priority," the report stated. The guidelines are part of an overall effort to explain the principles underlying Japan's economic assistance. Stanford Japan Center's Orr notes that recent calls in the Japanese press for the government to clarify its ODA philosophy reveal that Tokyo still has far to go in articulating the rationale of foreign aid.[9]

A Look At Fundamental Foreign Aid Reform - A further definition of Japan's foreign aid program is under way. The latest administrative reform council, an ongoing effort to streamline operations of the Japanese government, has assigned review of the foreign aid program to a subcommittee on foreign relations; that group is expected to submit a report addressing ODA in early December. A draft report released in mid-November called for clarification of Japan's ODA strategy, including the principles to be considered in the implementation of foreign aid and plans for various regions. The final report also is expected to recommend that the government implement plans to expedite the screening of ODA projects, specify the roles and responsibilities of the agencies involved in yen loans, and improve aid implementation through a review of Japan's aid organizations.[10]

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[6] Telephone interview with Robert M. Orr, director, Stanford Japan Center, Kyoto Center for Japanese Studies, Kyoto, Japan, November 11, 1991.

[7] Japan Economic Survey, XV, No. 3, March 1991, p. 9.

[8] Telephone interview with John Sewell, president, Overseas Development Council, Washington, D.C., November 15, 1991.

[9] Orr, telephone interview, op. cit.

The suggestions of the advisory panel, which includes former government officials and private-sector representatives, will be refined by the parent group over a period of two or three years before final recommendations are sent to the prime minister. The government generally is expected to implement the council's recommendations, which some aid experts believe could have a major impact on the program. However, the time frame suggests that a significant restructuring of Japan's foreign aid program is still years away.

Continuing Challenges

Many of the issues under review by the administrative reform panel represent problems that long have persisted in Japan's foreign aid program. These include a policymaking apparatus complicated by the interplay among the four government agencies that share responsibility for aid. Another problem is understaffing of the aid bureaucracy. At the same time the most recent foreign aid review pointed to some steps Tokyo is taking to improve the implementation of its aid program, including: better project evaluation, selection and formation; increased aid-related research and training; more detailed country- and sector-specific aid policies; and expanded policy dialogue with recipients.

The 1991 report also acknowledged that Japan needs to expand its human contribution to the international community. The dearth of Japanese participants was highlighted during the Persian Gulf War; on Capitol Hill critics of Tokyo's contribution to the multilateral effort cited the absence of a greater physical presence as evidence of a lack of Japanese commitment.

A Foreign Ministry assessment of 130 aid projects in FY 1990 cited several cases in which Japan's economic assistance went to waste because it did not match local needs. This analysis underscored a point made by many aid experts that increases in aid are useless without the staffing and the infrastructure capable of overseeing the application of funds.

Outlook

In a policy speech to the Diet shortly after his election as prime minister Kiichi Miyazawa indicated that Japan's role in establishing a peaceful global order can only grow. He reaffirmed Tokyo's commitment to work for arms control and for solutions to such international problems as protection of the environment, refugee resettlement, drugs and the needs of developing nations. Gradual changes in Japan's foreign aid policies appear aimed at lending the program a larger political role and may enable Tokyo to address such issues effectively through economic assistance.

The United States, burdened by a huge federal budget deficit, long has urged Japan and other nations to share global financial responsibilities. On a mid-November trip to Japan Secretary of State Baker encouraged Tokyo to expand its leadership not only in the economic arena but in attaining the objectives outlined by the Japanese government in the context of its foreign aid policy. This prompting is likely to continue as domestic demands impel Washington to reassess its approach to economic assistance. Many political analysts expect weakening support for foreign aid from the American public and their representatives in Congress, who are under increasing political pressure to address domestic problems before foreign needs. Both the United States and Japan face the challenge of balancing their aid programs within the shifting framework of domestic and international demands.

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[10] "Government Panel Calls for Formulation of ODA Outline," Asahi Evening News, November 11, 1991, p. 1.

For further information, contact Margo Grimm.

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The views expressed in this report are those of the author and no not necessarily represent those of the Japan Economic Institute.

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American Defense Officials Emphasize U.S. Commitment To Asian Security

Washington's efforts to underscore the U.S. commitment to Asia in a post-Cold War world continued in late November with visits to Japan and South Korea by Secretary of Defense Richard Cheney and Gen. Colin Powell, chairman of the joint chiefs of staff. Their discussions came on the heels of mid-November meetings in Tokyo and elsewhere in the region by Secretary of State James Baker and U.S. Trade Representative Carla Hills (see JEI Report No. 44B, November 22, 1991).

Gen. Powell's November 18 meetings with Prime Minister Kiichi Miyazawa, Adm. Makoto Sakuma, chairman of the Self-Defense Forces joint staff council, and others were particularly noteworthy as this was his first visit to Japan as chairman of the U.S. armed forces. Given his stature in the American military -- as well as the enhanced prestige he has enjoyed for his leadership role in the Persian Gulf War -- Gen. Powell's one-on-one discussions with Japanese

- A strong system of bilateral security arrangements;
- A modest but capable forward deployment of U.S. forces;
- A sufficient overseas base structure;
- Assumption by U.S. allies in Asia of greater responsibility for their own defense; and
- Greater complementarity in defense cooperation, involving joint training and the use of interoperable equipment.

"[These] are powerful principles for security in Asia," Mr. Cheney told his audience. "All [of the principles] are well-rooted in practice, yet flexible enough to accommodate the changes we can expect in the years ahead." Under the rubric of greater defense burdensharing by U.S. allies, the defense secretary said, Washington expects Tokyo to buy more American-made military hardware to facilitate cooperation in regional defense activities. This politely worded expectation may be a harbinger of more insistent future demands from American legislators who are frustrated by the bilateral trade imbalance and U.S. competitiveness problems as well as fearful of a "technology grab" by Japanese companies involved in licensed production or joint development of advanced weapons systems with U.S. defense contractors.

The defense secretary also praised the recently concluded five-year host-nation support agreement, in which Japan agreed to pay 73 percent of the nonsalary costs of stationing U.S. troops in Japan. Referring to the loss of U.S. bases in the Philippines, Mr. Cheney sought to reassure the Japanese government about the potential local impact. (A volcanic eruption last June forced the closure of Clark Air Base, and the Philippines Senate later rejected a contract that would have allowed the U.S. naval station to stay in Subic Bay.) "We have no desire to increase the burden on Japan as a result of developments in the Philippines," Mr. Cheney said. "There may be some additional units temporarily assigned to places like Kadena [air base in Okinawa], but only with the concurrence of the Japanese government."

The defense secretary also asked for Japanese cooperation in helping Moscow convert Soviet defense plants to civilian use. The domestic turmoil in the Soviet Union warrants close attention, he reportedly said. While Washington was pleased that Soviet President Mikhail Gorbachev responded favorably to President Bush's announcement last September of drastic unilateral reductions in nuclear arms, Mr. Cheney indicated that some U.S. quarters are concerned that the current lack of political coordination and severe economic problems in the 12 Soviet republics may impede central government efforts to reduce the Soviet nuclear arsenal. Other areas where Mr. Cheney said Tokyo could play an important regional leadership role include overseeing implementation of the Cambodian peace accord as well as pressuring Vietnam to resolve questions on the whereabouts of Americans listed as missing in action in the Vietnam War.

Barbara Wanner

Japanese Banks: Riding High Toward A Precipice?

Conflicting reports on the financial health of Japanese banks have surfaced over the past several months and generated debate over the soundness of the entire Japanese financial sector. On the positive side of the ledger most Japanese banks reported improved profits for the six months ending September 30; that news sharply contrasts with manufacturers' reports of lower earnings. The reported increases in nonperforming bank loans, however, present a bleak picture, as does the high potential for real estate loan defaults. Acknowledging the clouded outlook, foreign credit-rating companies have downgraded the ratings of many top Japanese banks over the past year. An increasing number of Japanese analysts and policymakers are worried that ailing banks will hobble economic growth.

According to data gathered by Japan's top economic daily, Nihon Keizai Shimbun, Japan's 11 nationwide commercial banks posted an average 17.3 percent increase in pretax profits and an average 8.4 percent gain in aftertax profits in the April-September 1991 period even though their operating income dropped by 2.2 percent on average (see Table). Analysts point to a wider spread between the banks' costs of raising funds and their lending rates as the primary source of higher earnings.

Since January banks have lowered the rate of interest they pay on certificates of deposit by an average 1.39 percentage points. (CD rates are a benchmark instrument in Japan's money markets and largely determine the banks' costs of raising funds.) Over the same period banks have cut the interest they charge on loans to their best corporate customers by only 0.875 percentage point. Until the decline in the prime lending rate equals the reduced CD rate the interest rate gap will continue to boost bank profits.

The interest rate spread, however, is not the whole explanation. Only four of the 11 nationwide commercial banks posted operating revenue gains; of these four, three showed increases of less than 1 percent. Changes in operating revenues seem to have had little relation to changes in profits, according to the data for the first half of FY 1991. Dai-Ichi Kangyo Bank, Ltd., for example, posted a 4.3 percent drop in operating income but a 23.4 percent increase in pretax profits. The contribution to profits of nonoperating revenues remains important, if not vital, to banks. Despite this year's dismal performances by the Japanese stock and bond markets, banks have continued to actively manage their investment portfolios to generate profits. There is some question, though, whether they can maintain profit growth in the face of a number of negative factors.

Japanese banks' investment portfolios are important for several reasons. By selling their holdings they can realize profits and pad their financial results. A portion of latent securities portfolio profits also can be counted toward meeting the stringent 1993 capital-asset ratios set by the Bank for International Settlements. As shown in the Table, the latent securities profits of banks suffered heavily in FY 1990 and recovered only slightly in FY 1991's first half. The banks' BIS capital-asset ratios track the movement of their latent securities profits. A bearish stock market not only further reduces the value of latent securities profits but also makes it more difficult for firms to realize those profits if needed, since selling in a depressed market only adds to downward pressures. Given the weak-kneed performance of Japanese equity and bond markets in 1991, many analysts view the reliance by Japanese banks on their investment portfolios as a liability.

Japanese and foreign financial analysts increasingly are concerned that the quality of banks' loan portfolios also may be an Achilles' heel. The value

Business Results of Selected Major Japanese Banks, First Half FY 1989-FY 1991

(in billions of yen)

	Operating Revenues	Net Profits	Total Assets	Latent Stock Profits	Nonperforming Loans	BIS Capital Ratio
Commercial Banks						
Dai-Ichi Kangyo Bank, Ltd.						
FY 1989	Y1,767.6	Y80.2	Y60,193.9	Y4,852.9	Y346.6	8.28%
FY 1990	2,224.2	53.7	65,080.6	1,780.0	247.4	7.30
FY 1991	2,129.1	92.6	62,503.1	2,219.6	n.a.	8.38
Mitsui Taiyo Kobe Bank, Ltd.						
FY 1989	1,612.2	64.3	57,308.9	5,731.6	367.6	7.05
FY 1990	2,157.2	44.1	61,642.1	2,389.6	263.9	7.22
FY 1991	2,094.7	80.0	60,152.5	2,820.7	n.a.	7.57
Sumitomo Bank, Ltd.						
FY 1989	1,829.5	97.1	56,239.7	3,919.3	391.2	8.44
FY 1990	2,315.4	70.1	60,914.9	1,621.1	299.4	7.81
FY 1991	2,206.2	138.7	59,906.0	1,913.8	n.a.	8.94
Mitsubishi Bank, Ltd.						
FY 1989	1,652.2	80.4	52,774.3	4,544.6	376.1	8.46
FY 1990	2,027.0	53.0	58,088.0	1,875.6	260.3	8.40
FY 1991	2,028.1	96.2	58,445.9	2,381.9	n.a.	8.71
Fuji Bank, Ltd.						
FY 1989	1,557.9	83.7	55,681.8	4,322.3	335.3	8.24
FY 1990	1,998.9	60.7	58,100.4	1,633.1	247.0	8.01
FY 1991	1,975.9	112.4	57,839.2	1,944.1	n.a.	8.72
Sanwa Bank, Ltd.						
FY 1989	1,607.4	80.2	52,919.3	4,163.1	322.5	8.45
FY 1990	2,045.6	61.3	59,013.2	1,728.0	237.9	7.50
FY 1991	2,038.0	117.4	55,738.0	2,077.7	n.a.	8.50
Tokai Bank, Ltd.						
FY 1989	985.8	34.9	34,332.7	3,205.8	304.6	7.72
FY 1990	1,337.0	30.5	36,506.3	1,454.2	209.8	7.87
FY 1991	1,360.8	48.1	35,915.3	1,668.9	n.a.	8.34
Kyowa Saitama Bank, Ltd.						
FY 1989	830.6	36.6	30,345.0	3,181.4	193.7	8.50
FY 1990	1,166.5	28.5	32,669.6	1,358.5	136.5	8.10
FY 1991	1,063.4	63.0	30,235.7	1,487.4	n.a.	8.90
Bank of Tokyo, Ltd.						
FY 1989	954.9	32.6	29,610.6	1,882.9	679.1	8.02
FY 1990	1,129.5	26.0	31,211.5	522.6	502.2	7.86
FY 1991	1,138.0	81.5	29,783.1	832.3	n.a.	8.50
Daiwa Bank, Ltd.						
FY 1989	531.8	24.8	17,183.4	1,978.3	98.1	8.41
FY 1990	718.2	19.0	17,969.6	983.2	61.2	8.20
FY 1991	692.5	32.9	18,091.0	1,101.9	n.a.	9.01
Hokkaido Takushoku Bank, Ltd.						
FY 1989	313.6	11.3	10,909.0	1,017.2	105.8	8.33
FY 1990	377.5	9.0	11,277.8	355.5	451.8	7.60
FY 1991	379.4	16.6	11,017.4	480.7	n.a.	8.80
Long-Term Credit Banks						
Industrial Bank of Japan, Ltd.						
FY 1989	1,265.1	51.1	40,533.5	5,518.5	247.7	7.80
FY 1990	1,527.3	38.1	44,956.7	1,990.0	193.0	7.40
FY 1991	1,467.9	87.3	42,615.7	1,990.0	n.a.	9.39
Long-Term Credit Bank, Ltd.						
FY 1989	891.5	36.4	26,819.5	4,007.0	294.3	8.23
FY 1990	1,095.6	33.0	30,447.2	1,553.4	223.5	7.60
FY 1991	1,060.0	43.6	30,371.5	2,042.6	n.a.	8.56
Nippon Credit Bank, Ltd.						
FY 1989	546.4	22.3	17,080.2	2,120.2	167.6	7.30
FY 1990	699.0	12.4	13,427.9	610.0	125.6	7.70
FY 1991	688.7	27.4	18,345.8	930.1	n.a.	8.03

Source: Japan Economic Journal, December 1, 1990, and Nikkei Weekly, November 30, 1991. Reprinted with permission, Nihon Keizai Shimbun America, Inc., New York, New York.

of nonperforming loans reported by major banks in FY 1990 fell. This fiscal year, however, the fallout from the unwinding of the overheated domestic real estate market is beginning to appear. Overall bankruptcies are up sharply in 1991; real estate-related failures lead the way. While banks list only a relatively small portion of their total loans as real estate-linked (usually around 10 percent), the figure actually is much higher because many corporate borrowers have used the lent funds to speculate in land. The Bank of Japan successfully has reined in real estate speculation through tight credit controls, but the speculative excess has not yet been drained from the system. A major concern is that rapid deflation of real estate prices would risk widespread default by borrowers, perhaps dragging down lenders with them. BOJ as well as the Ministry of Finance hope to avoid this worst-case scenario by gradually easing credit to the real estate market, but they are walking a very thin line. Most observers currently predict that, beginning in 1992, bank profits will begin to weaken under the impact of loan defaults.

Jon Choy

Japan's New Census Of Manufactures Reflects Currency Changes Since 1985

Like geologists, economists tend to see structures as undergoing rapid change where others observe what appears to be an unaltered landscape or, at most, glacial movement. Japan, with its active volcanoes and vibrant economy, provides an example for both the geologist and the economist. To some analysts Japan's persistently high trade surplus appears to be evidence that the landscape has not changed much; many observers have argued, for example, that policy measures initiated in the late 1980s had no impact on the Japanese economy. The recently released Census of Manufactures for 1990, however, points to structural change that, in part, reflects new patterns arising in the wake of the yen's post-1985 appreciation.

The Ministry of International Trade and Industry annual census of manufacturers provides output, employment and investment data on manufacturing workplaces having four or more employees as of December 31 of each year. (For further details about the census, see JEI Report No. 23A, June 17, 1988.) For example, shipments, calculated in nominal terms, rose 8.1 percent in 1990 from the year before to Y323 trillion ($2.4 trillion at Y135=$1.00).

The hundreds of industries covered by the census are classified into three groups: basic, assembly and other industries. These three groups enter into trade in substantially different ways. Basic industries, where trade is roughly balanced, import and export about 7 percent of their total output in aggregate. Processing and fabricating industries, by contrast, sell abroad nearly a quarter of their output but purchase very little from overseas. The third group of industries manufacture products that are neither exported nor imported in large amounts.

The yen's appreciation, which was virtually continuous from late 1985 to early 1988, played a role in stopping a long-run decline in the share of output accounted for by Japan's basic industries relative to processing and fabricating industries (see Table). From 1985 through 1988 basic industries like steel and chemicals grew in relative importance, while such assembly industries as

Trends by Industry Groups in Japan, 1980-90

(percent of total value added in manufacturing)

	Basic Industries	Processing and Fabricating Industries	Other Industries
1980	41.3%	34.4%	24.2%
1981	39.0	36.3	24.6
1982	38.3	37.0	24.7
1983	37.2	38.1	24.7
1984	37.1	39.4	23.5
1985	36.4	40.3	23.2
1986	36.8	38.8	24.4
1987	38.0	37.5	24.4
1988	38.0	38.5	23.5
1989	37.7	39.6	22.7
1990	36.8	40.7	22.5

Note: Basic industries include lumber and wood products; pulp, paper and paper products; chemicals and related products; petroleum and coal products; plastic products; rubber products; nonmetallic mineral products; steel; nonferrous metals; and fabricated metal products.

Processing and fabricating industries include nonelectric machinery, electric machinery, transportation equipment and precision instruments.

Other industries include food products; tobacco products, beverages, and feed; textile mill products; apparel and made-up textile products; furniture and fixtures; printing and publishing; leather and leather products; and other manufacturing.

Source: Ministry of International Trade and Industry

motor vehicles and consumer and industrial electronics declined. In short, the effect of the strong yen during this period was to redirect resources in manufacturing away from Japan's export-oriented industries.

Since 1989 the yen on average has been below the levels it reached in 1988. The two main industry categories have reversed direction again, with the value added by assembly industries growing relative to that of basic industries. (Value added roughly corresponds to the value of production less the cost of raw materials as well as depreciation charges.) Even "other" industries, which include most firms making products for daily consumption, have followed a pattern that reflects, in part, the ebb and flow of the Japanese currency. This group gained stature in response to the recession induced in part by the high yen in 1986; however, its relative importance eroded as investment spending at home accounted for an ever-larger proportion of the Japanese economy in the 1988-90 period.

In the early stages of the yen's appreciation some Japanese economists worried that employment in manufacturing would drop dramatically as firms moved their operations offshore. This "hollowing out" hypothesis appears credible since Ministry of Finance data show that the level of Japanese direct investment in overseas manufacturing soared during this period, jumping from an aggregate $24.4 billion on March 31, 1986 to a cumulative $81.6 billion on March 31, 1991. Employment in Japan's factories, however, did not follow the script. According to the latest census of manufactures, domestic manufacturing-sector employment peaked at 10.9 million workers in 1985 and 1986 and then dropped slightly to 10.7 million in 1987 before expanding to 11.2 million in 1990. This expansion helps explain the labor shortage that Japan has experienced since 1988. Normally, analysts would not expect substantial growth in the ranks of manufacturing-sector workers in a highly developed economy such as Japan's, especially since manufacturing firms have to compete in the labor market with growing services industries, many of which are labor intensive. Since both types of industries experienced increased demand for workers, a labor shortage was all but inevitable.

What of the future? The 1990 data may mark the end of another era. As growth has slowed this year in Japan, the manufacturing sector has weakened substantially by most of the measures included in the census of manufactures. Next year's census, which will be a snapshot as of December 31, may well reveal flat output levels, although manufacturing-sector employment probably will be up again. Over the next five years, however, employment in production industries may fall, given minimal immigration and 20 years of low birth rates. In short, the mountains of Japan's manufacturing sector are moving and will leave a dramatically altered landscape within the decade.

Douglas Ostrom

Japan Joins Call For Drift-Net Fishing Moratorium

A compromise worked out between Japan and the United States is expected to result in a worldwide moratorium on the use of large-scale drift nets on the open seas as of December 31, 1992 (see JEI Report No. 40B, October 25, 1991). The compromise, formally introduced by a U.S. representative at the United Nations December 2, revises a more stringent American call for a ban on the use of drift nets and a more accommodating Japanese recommendation that conservation measures be implemented to offset problems associated with incidental catches from drift nets. The incidental catch from the use of 30-mile or so lengths of netting by Japan's squid fleet has been estimated at 28 percent of the total catch, although some measures show a much greater percentage. Environmentalists say that the indiscriminate netting traps far more than the intended target and poses a threat to endangered species, such as green sea turtles, and possibly other fish, marine mammal and seabird stocks (see Table).

By going along with the revised U.N. measure Japan has agreed to cut by 50 percent its use of large-scale drift nets by June 30, 1992 and to phase out the use of the nets entirely by yearend 1992. One Japanese official indicated that, although the U.N. measure currently does not define "large-scale pelagic" nets, Japanese fleets on the open seas most likely will not adopt the shorter drift nets employed in domestic waters by European and American fleets. The 1989 Wellington Convention that called for an end to large-scale drift-net fishing in the South Pacific set forth a 1.55-mile-long drift-net limit. Since the smaller nets result in a much-reduced haul, the official said he expected

Catch and By-Catch of North Pacific Squid Drift-Net Operations, 1990

(number)

Species	Japan	South Korea	Taiwan
Neon Flying Squid	7,939,252	5,375,205	2,409,774
Other Squid	2,864	16,639	84
Salmon	9,729	74	1
Shark	89,568	21,460	6,480
Tuna	252,988	60,371	63,294
Pomfret	3,225,084	201,753	47,617
Northern Right Whale Dolphin	840	54	7
Pacific White-Sided Dolphin	459	29	5
Other Dolphin and Porpoise	437	32	6
Leatherback Turtle	27	2	--
Loggerhead turtle	1	--	--
Green Turtle	--	1	1
Seabirds	30,464	1,209	230

Notes: The May-December 1990 observations are not for direct comparisons since Japanese fishermen put far more observers on more vessels than did either of the other fleets.

For Japan the 1990 observations summarize those made by 35 Americans, 10 Canadians and 29 Japanese on 75 squid drift-net vessels. For South Korea the observations are those noted by 11 U.S. observers on 11 commercial drift-net operations and 13 Korean observers who monitored 13 operations. The observations listed for Taiwan are from 14 vessels monitored by 12 U.S. observers and nine vessels surveyed by Taiwanese observers.

Source: From reports of the national fisheries agencies of Japan (June 10, 1991), South Korea (September 20, 1991) and Taiwan (September 10, 1991) in cooperation with Department of Commerce, National Marine Fisheries Service, and Department of Interior, Fish and Wildlife Service.

Japanese fishermen to either develop a new fishing method or look anew at old techniques.

In crafting the compromise, which suggests a moratorium -- rather than Washington's preference for a ban -- on the use of large-scale drift nets, Tokyo accommodated international concerns rather than the interests of its domestic fishing fleet. The head of the Ministry of Agriculture, Forestry and Fisheries reportedly told the cabinet that the decision was shaped by other nations' responses to drift-net fishing and Japan's "position in the international community." Before announcing its decision to cut use of the drift nets, Japan was a primary target of pending congressional legislation that would impose trade sanctions on any country that violates the U.N. drift-net fishing resolution. Chief Cabinet Secretary Koichi Kato also referred to the external pressure and Japan's previously held view -- that more study is needed to determine whether drift-net fishing depletes or threatens species survival -- when he responded to a question at a news conference on whether drift-net fishing poses an environmental hazard. "There are various arguments about conserving resources," he said. "Our country was in a very tough position."

To help the domestic industry adjust to the U.N. measure, which is expected to pass by yearend, MAFF plans to request an as-yet undetermined amount of money to retrain or otherwise compensate the 10,000 workers employed in drift-net fishing in the North Pacific and the 50,000 people who process the squid, tuna and salmon caught there. By next June the 600-vessel fleet most likely will be trimmed.

Some reports say local fishing firms are confident of their ability to provide the Japanese population with one of their diet staples by fishing in domestic waters and continued international operations, but others relay severe criticism. Given the reduced profits of some Japanese fishing companies in the past year, the call might be loud in Tokyo for help in researching and developing new fishing methods, particularly from Japanese fishermen who do not want to be trained for new jobs. Tokyo's reaction to what plays internationally as an environmental problem but domestically as an economic problem may be of interest to American loggers in the Pacific Northwest, who face similar problems with calls to protect the spotted owl.

Pat Murdo

Notes

Satellites - Nippon Telegraph and Telephone Corp. has tapped Space Systems/Loral Inc. as the prime contractor for its pair of N-STAR communications satellites (see JEI Report No. 39B, October 18, 1991). The selection of what had been Ford Aerospace Corp. should work to the advantage of Mitsubishi Electric Corp. MELCO, which had teamed up with FAC to build the first three generations of communications satellites for NTT, was the big loser when Tokyo was forced to scrap the follow-on CS-4 project in the spring of 1990 as part of an agreement with Washington on nondiscriminatory procurement procedures for publicly funded commercial satellites. Along with Aerospatiale S.A. of France (one of three European minority investors in Space Systems/Loral) and Germany's Messerschmitt-Bolkow-Blohm, MELCO is part of a long-standing Space Systems/Loral-led satellite consortium. Toshiba Corp. and NEC Corp., Japan's two other satellite builders, also should get some N-STAR subcontracts.

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The views expressed in this report are those of the authors and do not necessarily represent those of the Japan Economic Institute.

STATISTICAL SUPPLEMENT

Trade and Payments Data

(in millions of dollars unless otherwise indicated)

	1989	1990	January-September 1990	January-September 1991	July 1991	August 1991	September 1991
Japan's Balance of Payments							
Trade Balance	$76,917	$63,528	$45,156	$71,917*	$8,644*	$8,246*	$10,946*
Exports (f.o.b.)	269,570	280,374	201,470	223,899*	25,740*	24,202*	26,989*
Imports (f.o.b.)	192,653	216,846	156,314	151,982*	17,096*	15,956*	16,043*
Current Account Balance	57,157	35,761	27,597	48,273*	5,035*	5,484*	8,830*
Long-Term Capital (net)	-89,246	-43,586	-42,318	33,489*	3,984*	11,844*	14,057*
Overall Balance	-33,286	-7,234	-10,100	48,815	6,281	19,148	15,942
International Reserves (end of period)	84,895	77,053	75,323	66,912	67,521	66,888	66,912
Japan's Customs Clearance Trade							
Trade Balance	64,328	52,149	41,241	54,411	6,665	5,749	9,684
Exports (f.o.b.)	275,175	286,948	206,126	229,479	26,620	24,813	27,658
Cars	38,804	41,348	29,928	32,550	3,762	3,446	3,892
Steel	14,789	12,509	8,991	10,028	1,177	1,085	1,122
Imports (c.i.f.)	210,847	234,799	164,884	175,067	19,955	19,064	17,974
Crude Oil	21,544	31,584	18,316	21,887	2,040	2,225	2,184
Manufactured Products	106,111	118,028	85,026	88,868	10,480	9,834	9,522
Japan-U.S. Trade							
Trade Balance	44,943	37,954	27,253	26,501	3,002	2,975	4,584
Exports (f.o.b.)	93,189	90,322	65,542	66,349	7,659	7,518	8,539
Imports (c.i.f.)	48,246	52,369	38,289	39,848	4,657	4,543	3,955
Yen-Dollar Exchange Rate (average for period)	Y137.96	Y144.79	Y149.46	Y136.23	Y138.01	Y136.89	Y134.58
U.S. Trade							
Trade Balance	-109,399	-101,718	-72,894	-46,556*	-7,776	-7,440	-6,852*
Exports (f.a.s.)	363,812	393,592	292,126	312,123*	33,507	33,584	34,584*
Imports (Customs)	473,211	495,311	365,020	358,679*	41,283	41,024	41,435*
U.S.-Japan Trade							
Trade Balance	-49,059	-41,105	-29,517	-30,923*	-3,797	-3,737	-4,183*
Exports (f.a.s.)	44,494	48,580	35,595	35,979*	3,851	4,021	3,662*
Imports (Customs)	93,553	89,684	65,112	66,902*	7,649	7,757	7,844*

*Preliminary

STATISTICAL SUPPLEMENT

Japanese Economic Indicators

(percent change from year-earlier period unless otherwise indicated)

	1989	1990	January-September 1990	January-September 1991	July 1991	August 1991	September 1991
Discount Rate (end of period)	4.25%	6.0%	6.0%	5.5%	5.5%	5.5%	5.5%
Outstanding Money Supply	9.9%	11.7%	12.2%	4.1%	3.4%	2.7%	2.2%
Industrial Production	6.1%	4.6%	3.7%	3.3%	2.5%	0.1%	0.9%
Manufacturing Operating Rate	2.2%	2.3%	1.6%	-0.2%	-0.2%	-3.4%	-2.8%
Number of Bankruptcies	-28.5%	-10.6%	-20.6%	64.0%	81.3%	74.3%	59.1%
Residential Construction Starts	-1.3%	2.7%	4.1%	-19.1%	-21.0%	-22.8%	-26.6%
Job Openings to Applications (ratio)	1.26	1.40	1.40	1.43	1.43	1.37	1.34
Nominal Wages	4.1%	4.7%	4.5%	3.9%	3.3%	6.7%	3.2%
Manufacturing Labor Productivity	6.2%	4.2%	2.2%*	4.8%*	n.a.	n.a.	n.a.
Wholesale Prices	2.5%	2.0%	2.1%	0.7%	0.4%	0.1%	-0.4%
Consumer Prices	2.2%	3.1%	2.9%	3.4%	3.5%	3.3%	2.7%
Yen-Based Export Prices	4.4%	2.1%	4.2%	-4.4%	-4.2%	-4.3%	-1.8%
Yen-Based Import Prices	7.7%	8.6%	8.0%	-5.1%	-5.7%	-7.8%	-11.9%

*Through June of each year only.

For Japan's latest GNP figures, see JEI Report No. 36B, September 27, 1991.

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REPORT

A Two-Part Report: A and B

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Tokyo Wrestles With Apology For Pearl Harbor Attack

After nearly a year of apprehension in Japan about how the commemoration of that country's December 7, 1941 attack on Pearl Harbor might precipitate a new round of "Japan-bashing" in the United States, Prime Minister Kiichi Miyazawa expressed "deep remorse" December 6 for his country's "unbearable attack" on the United States 50 years ago. This followed a similar statement three days earlier in which Foreign Minister Michio Watanabe acknowledged his country's blame for what then President Franklin Roosevelt called an act of infamy; Mr. Watanabe attributed the attack to the Japanese military's "reckless" decision to go to war with the United States. Both officials stopped short of offering an explicit apology due to sharp differences within the ruling Liberal Democratic Party over this issue. Although Mr. Watanabe said the national legislature "definitely" would pass a formal resolution expressing similar feelings of remorse, Japanese lawmakers were so divided over the appropriateness of an apology that December 7 came and went without Diet action on this purely symbolic, but politically significant, measure.

In a move that intrigued some political commentators Mr. Watanabe apparently sought to set a positive tone for the Pearl Harbor anniversary by granting an exclusive interview December 3 to a Washington Post Tokyo correpondent. According to Japanese sources, the Ministry of Foreign Affairs specifically chose the Washington Post because of its large policymaking readership. The Post's placement of the interview at the top of the front page of the December 4 issue pleased senior diplomats.

Speaking through an official interpreter, Mr. Watanabe said that the Japanese people "feel a deep remorse about the unbearable suffering and sorrow Japan inflicted on the American people and the peoples of Asia and the Pacific during the Pacific War, a war that Japan started with the surprise attack on Pearl Harbor." The foreign minister attributed Tokyo's aggression to "the reckless decision of our military . . . a fact we have to reckon with." No doubt in response to critics who have used the analogy that Japanese business practices and the government's economic policies have bitten the hands that fed them during the early, difficult postwar years, Mr. Watanabe credited American help and friendship since World War II as "the foundation for Japan's current prosperity." He added that even though Japan has emerged as a global economic power his country still "can't hold a candle" to the United States in terms of technology, discoveries and inventions.

Mr. Miyazawa virtually repeated these comments in a December 6 press conference. The Japanese government exercised great care over the wording of its remarks commemorating the Pearl Harbor 50th anniversary out of concern about current tensions in U.S.-Japan trade relations and the importance of sound relations with Asian neighbors. To offset the view in certain American quarters that Japan has adopted an almost cavalier attitude about how the United States helped the country rebuild after the war, some Japanese government officials felt it was important not only to offer an apology but also to convey a sense of gratitude for American support.

In its Pearl Harbor-related remarks Tokyo also wanted to help lay to rest residual fears in Southeast Asia about Japanese militarism. The Diet has been considering legislation that would authorize the dispatch abroad of Self-Defense Forces to participate in United Nations-sponsored peacekeeping operations. While Washington and most other allies have responded favorably to this initiative, some Southeast Asian critics have argued that the authorization would risk raising the specter of Japanese militarism experienced in World War II.

Senior Japanese officials devoted considerable attention to the English translation of the remarks by Messrs. Miyazawa and Watanabe in recognition that certain words in Japanese have different nuances and various translations. For example, in the Washington Post interview, Mr. Watanabe reportedly used the words fukaku hansei, which the Foreign Ministry, in working closely with the official interpreter, chose to have translated as "deep remorse." In other instances, however, these words have been translated as "deep reflection" or "contrition."

Japanese officials who wished not to be identified maintained that Foreign Ministry bureaucrats pushed for a stronger choice of words in Japanese but evidently encountered resistance from conservatives within the ruling party, who argued that Japan should not have to apologize for anything -- particularly since President Bush said December 1 that Washington would not apologize for its war-end nuclear attacks on Nagasaki and Hiroshima. The opposition parties long have urged a formal Japanese apology; the Social Democratic Party of Japan, in fact, began lobbying for a Pearl Harbor resolution early this year. The SDPJ reportedly proposed language on the order of "Japan expresses its deep apologies to its Asian neighbors and other countries" for its militaristic conquests leading up to and during World War II.

When Mr. Watanabe spoke with the Washington Post a compromise between the LDP and the political opposition appeared likely on the wording of a non-binding resolution that expressed "regret" or "remorse" for Tokyo's December 1941 attack on the Hawaiian base; the resolution also pledged that Japan never again would start a war. The agreement evidently was not firm, because LDP leaders could not persuade their more hawkish members to come to terms with pacifist-leaning and moderate members on appropriate language. SDPJ chairman Makoto Tanabe blasted Mr. Miyazawa and the ruling party December 8 for "turn[ing] [their] backs on the historical truth" by refusing to "sincerely apologize" for Japan's World War II military campaign.

Ignoring LDP lawmakers' paralysis on this issue, President Bush graciously acknowledged Mr. Miyazawa's formal statement of "deep remorse" concerning the attack on Pearl Harbor during somber December 7 ceremonies at the Hawaiian base. "It was a thoughtful, it was a difficult expression much appreciated by the people of the United States of America," the president said in the last of three speeches he gave early that morning at the National Cemetery of the Pacific, the USS Arizona Memorial and Kilo 8 Pier. He credited the Showa Emperor, who ruled during the war and was a figurehead leader until his death in 1989, with playing a "major role in the spiritual regeneration of Japan." Now is not the time for recrimination, Mr. Bush told a large gathering of World War II veterans and their families. He added, "I have no rancor in my heart toward Germany or Japan . . . and I hope, in spite of the loss, that you have none in yours."

Although he earlier had said that apologies for wartime attacks were unnecessary, the president took the occasion of the Pearl Harbor ceremonies to acknowledge that the U.S. internment during the war of some 120,000 Japanese-Americans was unfair. These natural-born American citizens of Japanese descent were "innocent victims, who committed no offense," the president said. Mr. Bush also used Japan's attack on the United States to comment on the danger of isolationism "and its economic accomplice, protectionism." In particular, the president called on U.S. trading partners in Europe and Asia to avoid economic isolationism. "To the leaders of Japan in particular," Mr. Bush said, "this solemn occasion should reinforce our determination to join together in a future energized by free markets and free people."

Barbara Wanner

Japan's Economic Growth Slows Further

Tokyo's spin doctors professed to be pleasantly surprised at the Economic Planning Agency's news that Japan's price-adjusted gross national product grew 1.6 percent on an annual basis in the July-September period (see Table). Never mind that the pace was the slowest in more than two years, they seemed to say, the performance was much better than the expected negative growth. The components of GNP, however, suggested a grimmer reality: Japan's economy showed the classic symptoms of an economy in the early stages of a slowdown.

Typically, housing is among the first sectors to show weakness in a slowdown; the latest EPA report indicated that residential construction had declined for the fourth straight quarter. Another sector that usually weakens early in the slowdown process is corporate plant and equipment spending. In the

Japan's Real Gross National Product at Constant (1985) Prices

(in billions of yen, seasonally adjusted, quarterly totals and rates of growth at annual rates)

	FY 1989	FY 1990	October-December 1990	January-March 1991	April-June 1991	July-September 1991
Gross Domestic Product	n.a. (n.a.)	Y406,615.1 (5.7%)	Y407,721.5 (4.0%)	Y414,372.6 (6.8%)	Y418,446.7 (4.0%)	Y419,799.1 (1.3%)
Gross National Product	Y387,502.0 (4.6%)	409,167.8 (5.6%)	409,798.1 (4.0%)	418,093.0 (8.3%)	421,003.9 (2.8%)	422,628.7 (1.6%)
Personal Consumption Spending	224,935.9 (3.7%)	234,101.1 (4.1%)	233,610.0 (-0.7%)	234,948.3 (2.4%)	238,652.2 (6.4%)	240,766.6 (3.6%)
Private Residential Construction	21,787.0 (0.9%)	22,833.7 (4.8%)	22,998.0 (-6.3%)	22,576.7 (-7.2%)	21,110.7 (-23.4%)	20,639.5 (-8.6%)
Private Fixed Nonresidential Investment	79,197.7 (14.5%)	88,847.4 (12.2%)	90,253.3 (12.8%)	92,263.4 (9.4%)	91,559.7 (-3.0%)	92,157.6 (2.6%)
Change in Business Inventories	3,677.3 (*)	2,910.4 (*)	2,666.1 (*)	3,071.8 (*)	3,172.3 (*)	2,742.3 (*)
Government Current Expenditures	33,618.8 (1.8%)	34,420.1 (2.4%)	34,518.7 (7.4%)	35,036.8 (6.6%)	35,595.7 (6.2%)	35,082.2 (-5.6%)
Government Fixed Investment	24,957.9 (-0.2%)	26,250.7 (5.2%)	25,981.2 (5.2%)	26,143.3 (2.6%)	27,378.4 (20.1%)	27,459.8 (1.2%)
Change in Government Inventories	-59.1 (*)	91.6 (*)	-601.7 (*)	80.2 (*)	-199.8 (*)	240.8 (*)
Net External Sector	-613.5 (*)	-287.1 (*)	372.4 (*)	3,972.5 (*)	3,734.7 (*)	3,539.9 (*)
Exports of Goods and Services and Factor Income Received	68,437.0 (15.6%)	73,723.0 (7.7%)	73,445.5 (11.0%)	76,508.5 (18.0%)	74,796.4 (-8.6%)	76,403.7 (8.8%)
Imports of Goods and Services and Factor Income Paid	69,050.5 (20.2%)	74,010.1 (7.2%)	73,073.1 (-4.2%)	72,536.0 (-3.0%)	71,061.7 (-7.8%)	72,863.8 (10.5%)

*Cannot be calculated or meaningless.

Source: Economic Planning Agency

fiscal year that ended March 31 capital expenditures accounted for a remarkable 21.7 percent of real GNP, but business investment grew only slightly in the July-September period and not by enough to offset the weak, revised figure for the previous quarter. As a result, such spending still was below that recorded in the January-March period.

The foreign sector and consumer spending, which initially are often resilient in the face of an economic downturn, played their expected roles in the most recent quarter. Exports, which depend mostly on the health of foreign economies, not the domestic one, remained relatively strong. Imports, in general, are harder to forecast. In the last two quarters they have moved in the same direction as exports, thereby leaving the foreign sector with little net influence on aggregate demand.

Consumer spending typically weakens only in the face of certified weakness in the economy, in part because labor market conditions and wage payments are among the last to be affected by a downturn. Particularly in the latest period, consumers ended up carrying virtually the whole burden of generating economic growth. Consumer spending added 0.5 percentage point to the quarterly growth total of 0.4 percent, suggesting that, absent this factor, the Japanese economy would have contracted in the July-September quarter.

Inventory behavior in the late summer and early fall also was consistent with the view of a still-spreading slowdown. Inventory accumulation has yet to drop off markedly, suggesting that firms remain tentative about trimming production. Should inventories -- now at the highest level since the last recession -- continue mounting, producers will be forced to cut back.

Government spending, which plays a relatively small role in Japan's economy, has shown an erratic pattern in recent periods. The revised data covering quarters since last fall for current public expenditures and fixed public investment, the two major components of government spending, reflected sharp upward adjustments from the figures announced three months ago. However, the figures for the July-September quarter indicated a slowing of that growth. The acceleration in government fixed investment, assuming it resumes, is likely to please Washington, which has pushed for sharply higher public works expenditures.

The revised figures for earlier quarters are part of a substantial Economic Planning Agency reworking of the GNP data. At the same time that it announced revised GNP figures EPA released data on gross domestic product for recent quarters. Most experts regard GDP as a superior indicator of an economy's health, which is one reason GDP is the standard measure in much of Europe. In contrast to GNP, GDP does not include income earned by capital invested abroad or by residents working in foreign countries. Neither the Japanese nor the American GNP figures differ substantially from their GDP counterparts since foreign workers and overseas investment in each country account for a relatively small fraction of total economic activity. However, as in the United States, which shifted to an emphasis on GDP over GNP for the data pertaining to 1991's third quarter, Japan has experienced more variation in GNP than GDP over the last year or so because net overseas factor income has fluctuated wildly. For example, annualized GNP grew a revised 8.3 percent in the January-March quarter. By contrast, GDP grew only 6.8 percent in the same time frame. In the second quarter GNP and GDP reversed roles; GNP grew a scant 2.8 percent, while

GDP rose 4 percent. (In the July-September period GNP and GDP grew at approximately the same rates -- 1.6 percent and 1.3 percent, respectively.) As this example illustrates, differences in the two measures tend to cancel out over time.

In general, GDP has shown a smoother and, arguably, more realistic quarterly growth path in both the United States and Japan. However, unlike the American media, the Japanese press did not move immediately to emphasize GDP. The likelihood is that the two measures will share the spotlight in Japan, with the component sectors, as shown in the table, summing to GNP rather than GDP.

By whatever measure, recent private-sector forecasts imply that Japan's economic slowdown is not likely to be reversed soon. For example, the economic research arm of Fuji Bank, Ltd., after analyzing the July-September figures, predicted that real FY 1991 growth will come to 3.5 percent. While this figure seems to imply a fairly good economic performance, no economic growth at all in the remaining two quarters of FY 1991 would leave full-year growth at 3.2 percent. The estimates made by the Fuji Bank unit are typical; most forecasts suggest that any expansion in the next two quarters is expected to be minimal. While such prognostications hardly evoke an economy in a free-fall, they do imply that Japan is sharing in the worldwide slowdown of economic activity in the early 1990s.

Douglas Ostrom

Tokyo Finds Fiscal Cupboard Bare

As the evidence of slower domestic economic growth accumulates (see preceding article), budget analysts with the Ministry of Finance and Liberal Democratic Party are scrambling to shore up lagging revenues while revising spending priorities. As is true in most countries where politicians talk about raising taxes, such suggestions in Japan have generated criticism from individuals as well as domestic and foreign corporations. Furthermore, MOF has taken a tough stance against greater spending despite a growing popular chorus calling for stimulative fiscal action. Against the backdrop of the struggling American and European economies, Tokyo's fiscal decisions strongly will influence the course of the global economy.

FY 1991 supplemental spending - Perhaps the starkest signal of Tokyo's fiscal problems is the almost invisible net increase in general account outlays in the government's proposed supplemental spending package for the current fiscal year (see Table 1). As approved by the cabinet December 6, the FY 1991 supplement would add just over Y266 billion ($2 billion at Y135=$1.00) to the initial general account budget of Y70,347.4 billion ($521.1 billion). The tiny increase will put revised spending growth for FY 1991 at just 1.4 percent over FY 1990's comparable figure of Y69,651.2 billion ($515.9 billion); this amount is quite a comedown from the initial FY 1991 budget's 6.2 percent gain. The small net increase breaks a pattern of large supplemental budgets seen over the past several years.

The tiny net change, however, masks some interesting points. Additions to FY 1991 outlays actually amount to Y1,728.6 billion ($12.8 billion), more than half of which is directed at two areas: disaster relief and a pay raise

Table 1: FY 1991 Supplemental General Account Budget

(in millions of yen)

Expenditures	
Increase	
Disaster-related expenses	Y608,429
Disaster relief payments	586,350
Agricultural damage payments	2,566
Other	19,513
Civil servant pay hike	326,664
Administrative expenses	80,849
Trade insurance special account appropriation	23,500
Housing/municipal infrastructure investment	166,662
Transfers to local governments	404,155
Other	118,371
Subtotal	1,728,630
Decrease	
Administrative expenses	-748,704
Transfers to local governments	-578,880
Overestimate for civil servant pay hike	-135,000
Subtotal	-1,462,584
Net Expenditures	266,046
Revenues	
Increase	
Construction bond issues	Y1,387,000
FY 1990 general account surplus	1,402,508
Other	340,516
Subtotal	3,130,024
Decrease	
Tax and stamp revenues	-2,782,000
Other	-81,978
Subtotal	-2,863,978
Net Revenues	266,046

Source: Ministry of Finance

for government workers. Categories that traditionally have been favored in the supplemental budget -- public works and foreign aid -- show very limited increases in the FY 1991 package. Spending cuts, however, are up sharply compared to previous years and total Y1,462.6 billion ($10.8 billion). Just over half of the cuts will come from a 10 percent reduction in every government agency's operating budget for the remainder of the fiscal year. Transfers to local governments also will be trimmed for the first time. The amount of transfers normally follows a fixed formula apportioning the revenues from a handful of taxes (see JEI Report No. 41A, November 1, 1991). Under this formula local transfers in the FY 1991 supplemental budget should have totaled Y983.1 billion ($7.3 billion). Under a special agreement local transfers in the FY 1991 supplement will be less than half that figure, or Y404.2 billion ($3 billion). These tough steps underscore MOF's determination to limit the need for government borrowing.

Issues of construction bonds, nevertheless, are to expand by Y1,387 billion ($10.3 billion), which is on top of the Y5,343 billion ($39.6 billion) listed in the initial FY 1991 budget. As an indication of how tight MOF considers the government's financial situation to be, this amount represents the maximum construction bond issuing authority for FY 1991 and will bring the general account's dependence on borrowed funds up to 9.5 percent from the initially targeted 7.6 percent mark. Another indication of the tightness of Tokyo's fiscal condition is the fact that the entire carryover from FY 1990 -- Y1,402.5 billion ($10.4 billion) -- will be used to fund current needs. In previous years MOF was able to "save" part of the previous year's surplus by transferring it to one of the government's special accounts. In FY 1991, however, Y998.3 billion ($7.4 billion) will be treated as general revenues, with the remainder transferred to local governments.

These revenue contortions are necessary because tax revenues are failing to meet MOF's projections. Revenues in the first seven months of FY 1991 (April-October) not only ran 1.6 percent behind the previous year's receipts for the same period but also contrasted sharply with MOF's expected 2.1 percent increase. In a reflection of tougher economic conditions revenues from only five taxes are running below FY 1990's levels: securities transactions (54.4 percent of last year's take), corporate income (82.5 percent), consumption (96.7 percent), gasoline (98.2 percent) and motor vehicle tonnage (99.8 percent). MOF analysts point to the shortfall in corporate taxes as the main culprit for the tight revenue situation.

In response to cries for greater fiscal stimulus MOF has decided to boost the Fiscal Investment and Loan Program, the government's second capital budget, by more than Y1,754 billion or $13 billion (see Table 2). This is an unusually large increase and will bring FILP growth for FY 1991 to 11.5 percent, nearly double the initial figure of 6.2 percent.

Table 2: FY 1991 Supplement to the Fiscal Investment and Loan Program

(in billions of yen)

National Forest Service	Y40.8
Public Enterprise Finance Corp.	295.0
Small Business Finance Corp.	130.0
Japan Railways Resolution Corp.	150.4
Foreign economic assstance	7.9
Hokkaido-Tohoku Development Corp.	20.0
Okinawa Development Finance Corp.	50.0
Japan Development Bank, Ltd.	300.0
Export-Import Bank of Japan, Ltd.	350.0
Local public organizations	370.0
Other	40.0
Total	1,754.1

Source: Ministry of Finance

FY 1992 tax policy - The financial gymnastics evidenced in FY 1991's supplemental budget, however, may seem simple in contrast to the maneuvers taking place in the FY 1992 budget process. Just a month ago private and MOF number-crunchers were projecting a FY 1992 revenue gap of as much as Y6 trillion or $44.4 billion (see JEI Report No. 41B, November 1, 1991). According to December 6 testimony by MOF officials before the Diet, the projected shortfall has been downgraded to Y2.2 trillion ($16.3 billion); this sharply improved forecast still represents a weighty problem. To bridge the gap MOF and the ruling Liberal Democratic Party are weighing several options:

- Extending special taxes - In coming up with funding for Japan's Y1.8 trillion ($13 billion) contribution to the multinational coalition that freed Kuwait from Iraqi occupation Tokyo imposed, for FY 1991 only, a surcharge of 2.5 percentage points on corporate income taxes and raised the tax on gasoline from Y2.04 (1.5 cents) per liter to Y3.06 (2.3 cents) per liter, or from about 6 cents to 9 cents per gallon (see JEI Report No. 9B, March 8, 1991). MOF and LDP officials initially suggested extending these taxes beyond their March 31, 1992 expiration date as one revenue-generating measure. (The two taxes were projected to raise Y670 billion or $5 billion during FY 1991.)

The proposed extension has angered the business community and fractured both the ruling and the opposition parties. Although a general agreement appears to have evolved to replace the corporate income tax surcharge with a slightly less burdensome levy, there is no consensus about continuing or replacing the special gasoline tax. Neither has a consensus developed over the exact level of the new corporate income tax surcharge.

- Automobile tax - When the 3 percent consumption tax replaced a host of targeted commodity taxes in FY 1989, car buyers did not get as big a break since special tax rates were worked out, dropping the previous 18 to 23 percent levy to 6 percent for three years; beginning in FY 1992 new car purchases were to be taxed at 3 percent, like any other item. MOF and LDP officials have raised the possibility that the cut to 3 percent, set for April 1, may be delayed at least one fiscal year.

The proposal has been criticized by both domestic and foreign automotive makers. Opponents point out that the rate cut would make only a small dent in revenues but conceivably could generate sales of an additional 100,000 vehicles; the additional sales, in turn, would boost tax receipts by Y118.1 billion ($875 million), covering a large part of the projected Y200 billion ($1.5 billion) loss of revenues due to the lower rate.

- Consumption tax - As an alternative, MOF and LDP officials have begun hinting that an increase in the current 3 percent consumption tax rate may be another revenue-raising option. Given the massive negative consumer reaction that greeted the tax when it first was implemented, this option may carry a high political price, even though consumers since have become resigned to the levy. This step is seen as a last resort, to be taken only when other alternatives fail to pan out.

- Other ideas - Both the LDP and the Finance Ministry have inaugurated panels to study new taxes for FY 1992 and beyond. One MOF suggestion is to divert revenues from a new national land-holding tax that will be introduced in FY 1992 (see JEI Report No. 47B, December 14, 1990). The original purpose of the tax was to stabilize land prices, but the suggested revision sees a new source of funding for government operations. Finance officials also have stated they are exploring additional indirect taxes to reduce the government's reliance on income taxes, which are heavily subject to the economy's performance. User fees and charges for the use of radio frequencies and other public goods regulated by the government are other options.

However MOF and the LDP decide to address the revenue gap, neither businesses nor individuals (either at home or abroad) are likely to welcome tax hikes at a time when the domestic economy is slowing. With upper house elections set for mid-1992, the LDP faces a politically hazardous fiscal course.

Jon Choy

102nd Congress Wraps Up First Session

Rushing to tie up loose legislative ends before the Thanksgiving holiday, lawmakers left Washington the evening of November 27 in a manner that hinted at next fall's election politics. Fearful that their absence could provide an opportunity for the Bush administration to seize the political agenda, legislators kept a door open in the Capitol to allow for a quick return. A technicality in the adjournment resolution would make it easier for Congress to regroup in December if necessary; it directs lawmakers to return January 3 to close the first session formally and to initiate the second. As usual, in the days before their departure lawmakers quickly passed bills they had debated for months and paved the way for other measures to proceed when the next session opens January 21 in the Senate and January 22 in the House. Among the issues Capitol Hill addressed in the final days of the first session were:

Banking reform - The banking bill that cleared Congress November 27 was far from the major overhaul of the banking industry envisioned at both ends of Pennsylvania Avenue earlier this year. The broad reform initiative had a difficult, winding route to travel, particularly in the House, where it fell under the jurisdiction of five committees. In early November the House rejected one reform measure (HR 6) that had been revised along the way (see JEI Report No. 25B, July 5, 1991 for an overview). Challenged by the White House and worried about the nation's economic health, House leaders eventually agreed that their work on a banking proposal would have to go beyond the essential step of bolstering the Federal Deposit Insurance Corp. On November 21 the House passed HR 3768, which focused on replenishing the alarmingly low reserves of the FDIC and reforming the deposit-insurance system for banks. That same day the Senate passed S 543, a broader bill that included a renewed effort to address perceived inequities between the treatment of foreign-owned financial institutions in the United States and that of U.S. financial institutions overseas. (For more on earlier congressional efforts to address this issue, see JEI Report No. 40B, October 25, 1991.)

House and Senate efforts to reconcile the two measures again narrowed the bill. The compromise measure written overnight November 26-27 and cleared by both chambers November 27 was pared down to include regulatory changes and a $30 billion line of credit for the FDIC. The bill steers clear of the questions that made banking regulation overhaul so controversial, including expanded powers and business opportunities for banks. Dropped in the conference committee

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JAPAN AND SOVIET FAR EAST DEVELOPMENT

Summary

Japan's cooperation in the development of the Far Eastern part of the Soviet Union often has been presented as assistance that could result in mutually beneficial returns. Joint development of the region's vast untapped natural resources potentially could benefit Japan, which is dependent on imported industrial inputs, while the Soviet Union, or more specifically the region itself, could acquire much-needed technical expertise and capital from Japan.

Although several joint resource development programs were launched in the 1970s, the high cost of development as well as the next decade's troubled international political atmosphere made further cooperation difficult. Also complicating bilateral economic ties was the Northern Territories dispute. Tokyo conditioned financial and technical help for the Soviet Union to movement on this issue, and that linkage discouraged Japan's private sector from greater involvement in Soviet Far East economic development.

Although Soviet President Mikhail Gorbachev's "new thinking" diplomacy resulted in dramatic changes in the international political arena, only minimal progress has been made on the territorial dispute. Moreover, the business climate in the Soviet Union has worsened over the last year or so as the demise of the communist regime has brought about both political and economic chaos.

Wary Japanese companies have responded coolly to Moscow's requests for expanded private-sector help. Although several billion dollars worth of development projects and a number of joint

business arrangements are under consideration, corporate Japan views support from Tokyo as a prerequisite for broad private-sector participation in the Soviet Far East's economic development.

Moscow's and Tokyo's Perspectives on Siberian Development

The Soviet Union,[1] especially Siberia, is endowed with one of the world's richest reserves of natural resources, spanning oil, natural gas, coal, nonferrous metal ores and various other minerals as well as forestry and marine resources. To date Moscow has put a priority on developing the resources and the industries of Western Siberia, which is close to the more populated areas of the country. Oil and gas development, for example, mostly has taken place in the Urals and Western Siberia. Pipelines connect drilling sites there with major industrial cities in the western part of the country; some pipelines extend as far as Western Europe.

Despite its vast natural resources, the eastern part of the country remains undeveloped. Transportation between east and west is a problem because it depends heavily on a single railroad. The combination of an undeveloped infrastructure, a harsh climate, a limited labor force and remoteness from industrial centers drives up resource development costs in Eastern Siberia and the Far East Soviet region. One researcher has estimated that, compared to the national average, construction costs alone run two to eight times higher there, while additional infrastructure, such as housing and roads, cost 10 times more and labor costs are 1.7 to 7 times higher.[2] Moreover, despite wage incentives, few workers and their families have settled in the eastern part of the country. Given these circumstances, development of the region appears a somewhat low priority of Soviet economic planners. As Soviet President Mikhail Gorbachev pointed out in a speech in Vladivostok in July 1986, "The region's share of all-union production [was] not only failing to increase but even falling."[3]

Development of Eastern Siberia and the Far Eastern area of the country requires enormous financial commitments and human resources that the Soviet Union cannot afford to provide on its own. In the past economic planners in Moscow have suggested that cooperation with East Asian countries, particularly Japan, would be a realistic way of facilitating development. These countries

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[1] Despite uncertain political developments that have changed the name and the makeup of the country formerly named the Soviet Union, this report will use the term Soviet Union for consistency's sake.

[2] Estimate by Victor Mote, cited in Sumiye O. McGuire, Soviet-Japanese Economic Relations (Santa Monica, California: Rand Corp., May 1990), pp. 37-54.

[3] "Text of Speech by Mikhail Gorbachev in Vladivostok, 28 July 1986," translated and provided by BBC Morning Service.

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not only could help supply the necessary capital and technology but would provide markets for the exploited resources. Outlining Moscow's first comprehensive policy for Soviet Asia in his Vladivostok speech, Mr. Gorbachev stressed the necessity of cooperation with Japan and other Asian countries to accelerate economic development in Siberia and the Far East region.

From the Japanese point of view, however, participation in Siberian and other Far East development is not as attractive a picture as the Soviet leader might hope to paint. The huge cost of development projects and their high-risk nature always have discouraged Japanese investors, even though Japan's business community long has acknowledged the potential benefits of diversified international sources of industrial and agricultural input supplies. The confusion and uncertainty increasingly gripping the Soviet economy over the last year or so has made Japan's private sector even more cautious. Also of concern is the estimated $500 million that the Soviets already owe for purchases of Japanese-made products (see JEI Report No. 29B, August 2, 1991).

Moreover, since big resource development ventures anywhere require sophisticated technology and often have to be backed up by official credit arrangements because of the the risks involved, an investor country's business sector tends to be sensitive to the political climate. Japan's economic relations with communist countries have fluctuated in recent years depending on the international political atmosphere; that has particularly affected extension of official credits and exports of high technology-related products. Although the recent dramatic changes in the political system of the Soviet Union portend a favorable climate in East-West relations over the long run, a too rapid and too uncertain transformation of the political system -- accompanied by dissolution of the Union of Soviet Socialist Republics -- has jeopardized the business atmosphere in the short term. Companies seeking to invest in the Soviet Union now not only have difficulty finding a reliable business partner but equally are hard-pressed to settle on a responsible government entity in control of business activities.

Japanese investors have the added worry of their country's claim for the return of four islands north of Hokkaido -- Shikotan, Kunashiri, Etorofu and the Habomai group -- that the Soviet Union has occupied since the end of World War II. The Northern Territories dispute has impeded full government support for the private sector's business dealings with the Soviet Union. Since Tokyo considers the prospect of Japanese financial and technical assistance for the Soviet Union as one of its very few bargaining chips in resolving the territorial impasse and negotiating a peace treaty (see JEI Report No. 18A, May 10, 1991), the government has taken pains to remind Japanese businessmen that any further commitment to Siberian or Soviet Far East development might undermine Tokyo's leverage.

Joint Development Programs in the 1970s

The early 1970s marked an exceptionally active period for postwar Japan-Soviet economic transactions. Japan's exports to the Soviet Union multipled almost fivefold between 1970 and 1975, while purchases from that country expanded 2.4 times (see Table 1). As a sign of the somewhat erratic year-to-year trade since then, the $5.9 billion value of 1990's two-way trade was only 2.1 times higher than the total in 1975.

Table 1: Japan's Trade with the U.S.S.R., 1970-91

(in millions of dollars; exports f.o.b., imports c.i.f.)

Year	Exports	Imports	Balance
1970	$341	$481	$-140
1975	1,626	1,170	456
1980	2,778	1,860	918
1981	3,259	2,021	1,238
1982	3,899	1,682	2,217
1983	2,821	1,456	1,365
1984	2,518	1,394	1,124
1985	2,751	1,429	1,322
1986	3,150	1,972	1,178
1987	2,563	2,352	211
1988	3,130	2,766	364
1989	3,082	3,005	77
1990	2,563	3,351	-788
1991 (January-September)	1,587	2,518	-931

Source: Japan Tariff Association

In the 1970s Soviet state entities and Japanese business consortia initiated several large-scale joint development projects backed by official loan agreements, including oil and gas exploration, production of logs and lumber as well as wood chips and pulp, port construction, and coal mining (see Table 2). These projects had a number of features in common. To make up for the Soviet Union's shortage of capital, especially the scarcity of hard currency reserves, the Export-Import Bank of Japan extended a loan to the pertinent Soviet state entity, which used the money to purchase machinery and equipment for a specific project from Japanese suppliers. The Japanese business consortium involved in a project agreed to import industrial inputs resulting from the development, like logs or coal, under long-term contract. Revenue from these exports was used to repay the Ex-Im Bank loan. Coordinating each project was the Japan-Soviet Business Cooperation Committee, which Keidanren (Japan Federation of Economic Organizations) and the Japan Chamber of Commerce and Industry set up jointly with a Soviet group comprised of the Soviet Ministry of Foreign Trade, state trade organizations and the Soviet Chamber of Commerce and Industry.

Several factors prompted the Japanese government and industry to participate in these projects: energy concerns related to the 1973-74 oil shock and political developments involving Japan-U.S. relations as well as U.S.-Soviet relations. Japan's industrial structure at the start of the 1970s was skewed toward such energy-intensive products as steel and chemicals. Over 70 percent of the country's FY 1970 energy requirements were met by oil, most of which was imported from the Middle East by multinational oil companies (see JEI Report No. 33A, August 24, 1990). Government and industry reacted to the first oil shock by scrambling to find alternative sources of energy supplies and implementing a variety of energy-conservation measures. Oil and gas development projects in Siberia and the Soviet Far East were seen as capable in the long run of helping to achieve the diversification objective, even though initial costs would be high. From that long-term perspective several business leaders, including the heads of Keidanren and JCCI, represented the Japanese business community in promoting joint development programs.

Table 2: Major Japan-Soviet Development Projects in Siberia and Soviet Far East

Project	Period	Japanese Imports	Japanese Exports	Export-Import Bank Credit Line
First Forestry Resource Development Project	1969-73	Logs: 7,600,000 cubic meters Lumber: 420,000 cubic meters	Sawmill equipment, transportation equipment and consumer goods	Supplier's credit: $163 million
Second Forestry Resource Development Project	1975-79	Logs: 17,500,000 cubic meters Lumber: 900,000 cubic meters	Sawmill equipment, transportation equipment and consumer goods	Buyer's credit: $550 million
Third Forestry Resource Development Project	1981-86	Logs: 12,000,000 cubic meters Lumber: 1,240,000 cubic meters	Sawmill equipment, other machinery and transportation equipment	Buyer's credit: $1 billion
Fourth Forestry Resource Development Project	1992-96	Logs: 6,000,000 cubic meters Lumber: 400,000 cubic meters	Sawmill equipment and transportation equipment	None (cash basis)
First Wood Chip and Pulp Development Project	1972-81	Chips: 8,050,000 cubic meters Pulp: 4,700,000 cubic meters	Sawmill equipment and consumer goods	Buyer's credit: $50 million
Second Wood Chip and Pulp Development Project	1986-95	Chips: 8,200,000 cubic meters Pulp: 3,000,000 cubic meters	Machinery and equipment	None
Vostochnyy Port Construction Project	1971-76		Construction machinery	Buyer's credit: $100 million (including $20 million of local costs)
South Yakutian Coal Development Project	1975-2000	Yakutian coal: 84.4 million metric tons Kuznets coal: 20 million metric tons	Machinery and equipment and consumer goods	Buyer's credit: $450 million plus $135 million
Yakutian Natural Gas Exploration and Development Project	1976-	LNG: 7.5 million metric tons a year for 25 years (suspended)	Oil exploration equipment	Buyer's credit: $25 million
Sakhalin Continental Shelf Oil and Gas Exploration Project	1975-	Oil: not fixed LNG: not fixed	Oil exploration equipment, including ships, and consumer goods	Loans*: $185 million (oil exploration equipment), $22.5 million (ships) and $30 million (local costs)

*Indirectly financed by Export-Import Bank.

Source: Japan-Soviet Business Cooperation Committee and Sumiye O. McGuire, Soviet-Japanese Economic Relations (Santa Monica, California: Rand Corp., 1990), pp. 12-19.

In the superpower political arena the key word at that time was detente. The 1972 agreements between Washington and Moscow produced by the Strategic Arms Limitation Talks dispelled some Cold War constraints and provided Tokyo an opening to improve relations with Moscow. That also was a period in which Tokyo felt some political embarrassment from then President Richard Nixon's surprise 1972 visit to Beijing. As a result, Japan tried to initiate diplomatic action -- especially the normalization of relations with communist countries -- that was independent of Washington's policy line, yet not anathema to it. After establishing diplomatic relations with Beijing, then Prime Minister Kakuei Tanaka visited Moscow in 1973, the first Japanese prime minister to do so since the resumption of bilateral relations in 1956. Meetings with Communist Party head Leonid Brezhnev provided Mr. Tanaka with a hope that the territorial issue would be included on the agenda of peace treaty negotiations. This expectation led Tokyo to take a flexible stance concerning extension of official credits to the U.S.S.R., and that enabled Japanese businessmen to initiate the joint development programs.

Development Programs Suffer in the Early 1980s

The temperate climate for Japan-Soviet economic relations did not last long. Not only did Cold War tensions return but the gradual shift of Japan's manufacturing sector toward less energy-intensive high technology industries lowered concerns about finding new, dependable energy supplies. Ministry of International Trade and Industry data indicate that Japan's energy consumption in FY 1988 was only 45 percent higher than in FY 1970, even though the country's inflation-adjusted gross domestic product had more than doubled over this period. Moreover, after the first oil shock Japanese industry tapped new coal, oil and gas sources in Southeast Asia and China. The availability of lower cost supplies there compared to what potentially was obtainable in the Soviet Union led to a downward revision of Tokyo's estimates of the importance to Japan of Siberian and Soviet Far East natural resources. On natural gas, for example, Japanese importers concluded enough long-term supply agreements to more than cover projected Japanese demand through the end of this century.

Rising Cold War tensions also complicated Japan-Soviet relations in the 1980s. Washington imposed a series of economic sanctions against Moscow in response to its late 1979 invasion of Afghanistan and the Soviet's indirect oppression of Poland's democratic labor movement. The U.S. sanctions included suspension of new official loans, strengthened restrictions on high technology-related exports, including oil and gas drilling equipment, and limits on high-level government exchanges. When Tokyo followed Washington with similar economic sanctions, Moscow ignored Tokyo's claim to the Northern Territories to the point of insisting that there was no territorial dispute between the two countries.

As a result of this deterioration in the international and bilateral political atmosphere, many business transactions with the Soviet Union, including joint development projects, faced delay or even suspension. For example, no meetings were held between September 1979 and December 1984 of the Japan-Soviet business committee set up to review existing projects and to discuss future cooperative proposals. The Japanese government unofficially asked business leaders during the early 1980s to refrain from visiting Moscow as part of its effort to restrict high-level personnel contacts.

More important, the hold on Ex-Im Bank financing for new joint development projects made it hard to conclude new agreements. The two sides agreed to move ahead with only one new big resource development project in the 1980s, the second wood chip and pulp program, which was launched without the use of official credits. In addition, restrictions that kept U.S.-made oil exploration and drilling equipment from reaching Sakhalin Island delayed an offshore oil and gas exploration project there. The withdrawal of El Paso Natural Gas Co. and Occidental Petroleum Corp. from a trilateral gas development program in the Yakut district because of Washington's economic sanctions compelled Japanese firms to freeze negotiations with Moscow on this program, too.

Another bilateral resource development project cancelled because of international political concerns involved oil development in Western Siberia; the project was to include construction of a pipeline to the Pacific Coast. Beijing, fearful that the pipeline also would improve the Soviet military's capability to deploy in the China-Soviet border area, expressed its opposition to the project; that was its death knell.

Gorbachev's Reforms and the Impact on Bilateral Economic Relations

Beginning in the late 1980s Mr. Gorbachev sought to enact economic and political reforms. These initiatives have had various results -- such as helping to ease political tensions between East and West. The new cooperative attitude of the Soviet Union persuaded Washington to reduce its opposition to many kinds of high technology transfers. Of concern to Tokyo, however, was how far Mr. Gorbachev's "new thinking" reforms would go toward settling the Northern Territories issue. At the April 1991 summit meeting in Tokyo between Mr. Gorbachev and then Prime Minister Toshiki Kaifu, the Soviet leader formally acknowledged the existence of a dispute over the four islands -- a small but first step toward resolution of the issue.

Growing awareness of the deep problems in the Soviet economy colors current international and bilateral relations. In July 1991 Mr. Gorbachev essentially went hat in hand to seek immediate and long-term financial assistance from the leaders of the seven major industrialized democracies meeting in London. The two most cautious respondents were Japan and the United States. Questioning the wisdom of providing a large amount of financial help to the Soviet Union, the seven world leaders agreed to limit support to technical assistance and emergency food aid (see JEI Report No. 28B, July 26, 1991).

Some analysts argue that improvements in the international and the bilateral political climate ultimately will benefit Japan-Soviet business transactions because the political obstacles to trade, which had resulted in government controls on high technology exports and limits on official credits, have been reduced substantially. Other observers point out, however, that Tokyo will continue to be hesitant about supporting business deals until Moscow makes concessions on the territorial issue. Tokyo now is even more assured of the effectiveness of economic assistance as a bargaining chip for its territorial claim than in the Cold War era.

Private Sector's Concerns about Radical Change - Improvements in the international political atmosphere have not persuaded Japan's business community to overlook the confusion that has resulted from the rapid transformation of the Soviet Union's political and economic systems. Even before the country's political situation began to degenerate quickly after the late August coup attempt against Mr. Gorbachev, corporate Japan was cool to eager Soviet entreaties for new business deals. For one thing, regulations designed to liberalize economic activities were changed frequently and left Japanese businessmen and others puzzled.

The recent accelerated dissolution of the Union of Soviet Socialist Republics is another reason for investors to wait to see what governing body finally will control the economic system. As an example of the current turmoil, many foreign businessmen now face difficulties in just finding an appropriate contact to handle negotiations. Until recently most business negotiations were conducted in Moscow with state entities, which monopolized trade with capitalist countries. Although tough negotiators from a business standpoint, officials of the former state trading organs typically had sufficient knowledge of trade with Western countries and proved to be reliable partners. Moreover, since state trading organizations controlled the distribution of products, they easily could handle countertrade arrangements. Representatives of these groups also were responsible for finding exportable products as a way of settling import bills from foreign countries without depleting the country's scarce foreign currency reserves.

In the current troubled political and economic climate most state trading organizations have been dissolved or have had substantial personnel turnover. Local governments and newly established private firms have begun to participate in trade and to ask foreign investors to conclude joint venture arrangements. Decentralization and privatization have raised concerns among representatives of foreign companies that these new, unfamiliar contacts will be naive about how market economies work and have little experience with foreign trade. Also of concern is that the Soviet Union's quality standards are insufficient for domestic products to be internationally competitive, despite the assumption at home that the goods will be sold easily. One fact-finding mission that visited the Soviet Union to review that country's progress in introducing a market economy raised the point that inspiring a business mentality among Soviet citizens well could be more difficult than rewriting economic regulations.

Several Japanese trading houses have set up representative offices in the Far East cities of Khabarovsk and Nakhodka; offices also are planned for Sakhalin. These offices, however, are designed mainly to collect information on the rapidly changing economic and political situation and to deal with the devolution of authority to local governments and private firms. Trading company officials do not expect to negotiate many business deals over the near term.

The Soviet sounding board that might have resolved some of the problems standing in the way of bilateral business deals, the counterpart to the Japan-Soviet Business Cooperation Committee, was left in disarray by the events following the failed August coup at the Kremlin. Many of the principal entities that took part in the Soviet-Japan Economic Cooperation Committee, such as the Soviet Chamber of Commerce and Industry, the Ministry of Foreign Trade and other ministries handling economic affairs, were ordered dissolved. Japanese committee members now are looking into the possibility of establishing a relationship with the Russian Republic's business community.

Soviet Economy and Bilateral Trade - The political confusion in the Soviet Union is not the only current obstacle to joint deals. So is a shortage of hard currency to pay for imports needed now or in the future. Then there is the country's accumulated foreign debt; $500 million-plus in payments to Japanese exporters alone are overdue. Although the Ministry of International Trade and Industry had planned to provide export insurance to cover the overdue payments as a part of a $2.5 billion financial assistance package announced this fall (see JEI Report No. 39B, October 18, 1991), the recent dissolution of the Soviet central banking system has scrambled plans for this help.

The payment problem became obvious in the late 1980s. For a number of reasons Japanese exports to the Soviet Union always have fluctuated. The drop in annual shipments since 1988 has been linked to the payment problem. Last year Japan shipped to the Soviet Union about $2.6 billion worth of goods; that represented only 0.9 percent of Japan's worldwide exports. Machinery and transportation equipment comprised more than half of these sales (see Table 3).

Table 3: Japan's Major Exports to the U.S.S.R., 1990

(in millions of dollars; f.o.b.)

Product	Amount	Share
Food	$9.6	0.4%
Textiles and Apparel	146.5	5.7
Chemicals	273.5	10.7
Plastic Materials	134.4	5.2
Nonmetallic Mineral Manufactures	10.1	0.4
Metals and Fabricated Metal Products	469.0	18.3
Steel	376.4	14.7
Fabricated Metal Products	77.2	3.0
Machinery and Transport Equipment	1,339.6	52.3
Textile Machinery	95.9	3.7
Television Receivers	119.1	4.6
Videocassette Recorders and Tape Recorders and Players	105.9	4.1
Scientific and Medical Equipment	74.1	2.9
Motor Vehicles	113.6	4.4
Other	314.6	12.3
Total Exports	2,562.8	100.0

Source: Japan Tariff Association

Conversely, imports from the Soviet Union have grown fairly strongly since 1985. In 1990 Japan recorded a trade deficit with the Soviet Union for the first time in 15 years. Last year Japan bought nearly $3.4 billion worth of Soviet products, the equivalent of 1.5 percent of total imports. Most of this trade consists of industrial raw materials like logs, coal and nonferrous metal ores; few value-added products are represented (see Table 4). Much of the coal comes in under a long-term contract related to a joint southern Yakut coal mining project that started in 1975; coal shipments began in 1985 and will end in 2000. Japanese purchases of Soviet nonferrous metals, particularly gold,

Table 4: Japan's Major Imports from the U.S.S.R., 1990

(in millions of dollars; c.i.f.)

Product	Amount	Share
Food	$322.4	9.6%
Fish	310.7	9.3
Textile Fibers	34.4	1.0
Metal Ores and Scrap	61.9	1.8
Other Raw Materials	560.7	16.7
Logs and Lumber	521.9	15.6
Mineral Fuels	630.3	18.8
Coal	464.0	13.8
Crude Oil	10.2	0.3
Petroleum Products	155.7	4.6
Chemicals	62.6	1.9
Steel	276.1	8.2
Nonferrous Metals	1,001.4	29.9
Machinery and Transport Equipment	15.0	0.4
Other	386.2	11.5
Total	3,351.0	100.0

Source: Japan Tariff Association

platinum and palladium, have grown steadily in recent years. Some of these precious metals serve as substitutes for hard currency and are used to pay Soviet bills owed to Japanese exporters.

Joint Ventures - Moscow's economic restructuring plans envisioned various options. One saw foreign companies setting up joint ventures with Soviet firms to manufacture value-added products and export some of the output to the foreign partner's home market. Also conceived as a possibility was the privatization of state-owned firms, including those involved in the defense industry; these, too, were viewed as candidates for joint ventures. Soviet authorities also reportedly were prepared to set up foreign trade zones in several cities, including Nakhodka and Sakhalin in the Soviet Far East. Companies operating in the proposed FTZs would get some tax relief and tariff exemptions on imported products; in addition, currency exchanges would be unrestricted, a feature designed to attract foreign investors. The most radical Soviet economic planners stressed that market mechanisms, represented by free pricing and liberalization of private property ownership, soon would be introduced to the whole country.

Of the 34 known agreements concluded as of this past April between Japanese companies and Soviet entities (see Table 5), most involve small joint ventures in the lumber and fish processing areas or in the tourism sector. A majority of the companies are fairly new and have not begun operations. Of the 34 ventures, 22 are located in Eastern Siberia and the Soviet Far East; 10 are in Moscow.

Some analysts say that several of the incentives that Moscow is prepared to offer to attract foreign investors are similar to those already available in

Table 5: Selected Japan-Soviet Joint Ventures as of April 1991

(in thousands of rubles unless otherwise identified*)

	Business	Total Capital	Location
1.	Lumber mill	2,000	Irkutsk
2.	Sales of sporting goods	130	Moscow
3.	Fish processing	122.5**	Khabarovsk
4.	Salmon and trout hatchery	21,600	Yuzhno-Sakhalinsk
5.	Fish processing and sales	7,000	Yuzhno-Sakhalinsk
6.	Construction of hotels and restaurants	40	Moscow
7.	Transportation service	2,500	Moscow
8.	Passenger service at airports	200***	Moscow
9.	Fish processing and sales	3,000	Khabarovsk
10.	Rental car service	1,600	Moscow
11.	Construction of restaurant	680	Kholmsk (Sakhalin)
12.	Tourism development	1,000	Kholmsk
13.	Tourism development and construction of restaurant	150	Irkutsk
14.	Lumber mill	1,200	Khabarovsk
15.	Sales of agricultural goods	1,210	Moscow
16.	Fishing, fish processing and sales	500	Khabarovsk
17.	Design of office automation system	60	Moscow
18.	Fishing, fish hatchery and sales	1,000	Yuzhno-Sakhalinsk
19.	Publishing and cultural exchange service	30	Moscow
20.	Fishing, fish processing and sales	30**	Magadan
21.	Construction of restaurant	150	Khabarovsk
22.	Communications services for businesses	800	Khabarovsk
23.	Imports of office equipment and cameras and customer service	3,150	Kiev
24.	Production of electronics products	2,000	Moscow
25.	Construction of hotel and tourism development	5,400	Yuzhno-Sakhalinsk
26.	Transportation of goods and tourism development	1,250	Khabarovsk
27.	Foreign currency retail stores	300***	Khabarovsk
28.	Fish processing	1,000***	Vladivostok
29.	Recycling of steel scrap and sales	7,760	Khabarovsk
30.	Lumber mill	6,500	Tyumen
31.	Lumber mill	1,000	Khabarovsk
32.	Hamburger shop	950	Moscow
33.	Processing and sales of crabs and lobsters	1,500	Vladivostok
34.	Ship repair and trading	100**	Nakhodka

*Various exchange rates were used to convert rubles into dollars. For example, 1.8 rubles=$1.00 in most trade settlements, although the official exchange rate is 0.56 ruble=$1.00. On the black market $1.00 is equivalent to about 20 to 30 rubles.

**Millions of yen.

***Thousands of dollars.

Source: Nihon Keizai Shimbun, April 10, 1991.

the People's Republic of China and Southeast Asian countries. Compared to these places, the investment atmosphere in the Soviet Union is less attractive -- and will remain so even when new foreign investment regulations are in place, analysts argue. The Soviet Far East's main detractions for foreign investors will remain a shortage of labor -- especially skilled labor, a poor infrastructure and a harsh natural climate. Moreover, the uncertainty surrounding the Soviet economy undermines the value of the ruble, so that even if Soviet authorities suggest that foreign investors will be allowed to repatriate their profits by converting rubles into foreign currencies, they cannot control declines in the ruble's value. That prospect further discourages foreign investment.

Resource Development - Soviet authorities have placed much hope on attracting Japanese investors through the lure of natural resources in Siberia and the Soviet Far East. One Soviet economic planner offered a blueprint of regional development projects to Japanese businessmen at a joint economic committee meeting in January 1991. One proposal was the full-scale development of oil and gas reserves in Sakhalin and Yakut, a project that has been suspended since the early 1980s. The planner estimated that complete exploitation of the two fields would yield 840 billion cubic meters of gas and 80 million metric tons of oil. Pumping is expected to begin in 1995 and continue until 2015. Plans call for extending a pipeline underwater to Japan as well as overland to the Korean peninsula and possibly to China. The cost of the first phase of the project, which would concentrate on exploitation of Sakhalin's reserves, has been estimated to exceed $15 billion.

Several Japanese companies are interested in the project from a long-term viewpoint. Four of the six international consortia competing for oil development rights in Sakhalin include Japanese participants. Although Moscow initially intended to award the development rights by this past October, political conflicts between the central government and the local government delayed the decision. The government of the Sakhalin district reportedly asked Moscow to review the blueprint; it wants to include local infrastructure work, such as construction of roads and rail lines, plus agricultural development. Most likely the oil and gas project will remain stymied until the central authority issue is resolved. Further delay is possible as Russian Republic authorities work out terms with local district entities. Time, however, stands on Japan's side. Since current long-term agreements with other countries will cover Japan's natural gas requirements through 2000, companies there do not feel compelled to seek out supply sources in Sakhalin right now.

Tokyo's Assistance to Business - Loans from the Export-Import Bank as well as MITI's trade and investment insurance program serve to encourage Japan's private sector to engage in business with the Soviet Union. Without that type of support Japanese exports and participation in joint ventures would continue to shrink despite demand from Soviet citizens and industry eager to gain access to Japanese goods and technology. Although in the near term loans and insurance benefit Japanese exporters at least as much as Soviet importers, the Soviet side definitely benefits as well in the long term since trade with industrialized countries remains a key to gaining the technological expertise the Soviet Union needs to recover from its current economic difficulties.

Another area in which government can assist business in a foreign country is through technical assistance. Technical assistance over the long term -- especially in the area of fundamental management training -- could be vital to introducing the workings of a market economy to the Soviet Union. Soviet factory managers have been invited to Japan by both the government and the private sector to gain an opportunity to see a market economy at work.

Whether or not Tokyo provides financial assistance on a major scale to the Soviet Union, or even something like foreign aid -- now reserved for developing countries, is a highly political issue, one related closely to progress on the Northern Territories dispute and in the peace treaty negotiations. Observers are certain that projects costing $10 billion and up, such as the Sakhalin oil and gas project, will not attract Japanese investors unless they get government support of some kind. Local infrastructure development also is considered a key project element. If a breakthrough occurs in the Japanese-Soviet, or Japanese-Russian, negotiations on a treaty to formally end World War II and if Tokyo decides to extend financial support for the Sakhalin and/or other Soviet Far East development programs, the prospects for additional Japanese investment certainly would improve.

The development of Eastern Siberia and the Soviet Far East has potential ramifications for the Soviet Union's other neighbors, including China and the two Koreas. Among the regional resource development proposals being studied is one calling for work in the Manchurian area of China bordering the Soviet Union and North Korea. If Tokyo and Pyongyang succeed in normalizing relations, Japan probably would participate in such a regional development project. Through economic assistance geared to the development of the Far Eastern region of Asia, Japan could play a major role in regional stability.

For further information, contact Tadashi Saito.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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REPORT

A Two-Part Report: A and B

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ENVIRONMENTAL DEVELOPMENTS OFFER OPPORTUNITIES FOR JAPAN

SUMMARY

Environmental concerns that have garnered newspaper headlines in the past four years or so, such as global warming and ozone depletion, have coincided with Japan's interest in taking a larger role in international affairs, including in environmental matters. Upcoming conferences offer diverse opportunities for Tokyo to exercise leadership; they also set the stage for potential areas of U.S.-Japan cooperation and conflict.

At both the upcoming Conference on International Trade in Endangered Species and the United Nations Conference on Environment and Development Japan has indicated an interest in moderating the interplay between developed and developing countries. The degree of involvement could signal how much leadership Tokyo is willing to assume in environmental matters. Influence is possible without leadership, however.

Japan's plans for international involvement in environmental issues rest strongly on its foreign aid program and its ability to serve as a role model, particularly in the areas of energy efficiency and air pollution control. Through such initiatives Tokyo hopes to increase its domestic and international impact on areas of potential climate change.

International Diplomacy in Environmental Matters

When several significant environmental conferences were scheduled for 1992 about two years ago, the year had all the trappings of a period in which the environment might enjoy abundant, constructive attention. About that same time Japan began positioning itself to take more of a leadership role on some global environmental concerns -- particularly those related to climate change. Its position of influence as one of the world's strongest economies and most efficient energy users as well as one that has dealt fairly successfully with a majority of its air pollution problems could serve to alter Japan's previous image among environmentalists as an ecological outlaw. Recent official and corporate interest in environmental issues also has improved that country's credibility.

Concern over environmental issues always has tended to play better in good times than in bad. Disheartening economic statistics from Washington, Tokyo and several European countries as well as events following the dissolution of the Soviet Union very easily could demand a more immediate response than long-term environmental concerns. Given the significance of the various international conferences to be held this year, the amount of attention diverted to the environment could indicate the degree to which ecological problems have become part of mainstream policy concerns.

Japan-U.S. Discussions - Clues that environmental matters might be rapidly downgraded in economic hard times have cropped up in reports about President Bush's early January visit to Japan. Before trade -- especially the huge bilateral imbalance in motor vehicles and parts -- became the main theme of the president's rescheduled trip, the environment had been on the agenda as an area of potential transpacific cooperation. Although as of this writing the president had not yet arrived in Japan, U.S. officials reportedly have urged Tokyo to revise the rules on automotive emissions testing and other certification procedures to hold down the cost of U.S.-made vehicles in Japan. The dispute, according to some sources, has less to do with actual emissions -- particularly since U.S. officials contend that emissions standards are the same in both countries -- and more with whether U.S. tests and sampling methods could be accepted as equivalent to Japanese procedures. Since Mr. Bush will have in tow the leaders of Chrysler Corp., Ford Motor Co. and General Motors Corp. when he arrives in Japan, the attention paid to the emissions testing dispute could sour planned announcements of cooperation on environmental ventures. Amelioration of the situation or further rancor could result, depending on whether the Big Three officials follow up on an invitation to a mid-January seminar on the global environment in Tokyo. The meeting is to feature discussions on cooperation in developing more environmentally benign cars. Among the participants will be the presidents of Toyota Motor Corp. and Nissan Motor Co., Ltd. as well as several environmental officials.

Even the somewhat theoretical proposals made by Japanese officials in late December for bilateral environmental cooperation contain room for disagreement. One proposal refers diplomatically to "promotion" of an upcoming United Nations Conference on Environment and Development. Washington's reluctance to go along with the other major industrialized countries on climate change proposals is most likely the reason Tokyo has chosen the word "promotion" for its proposal rather than urging Americans to agree to a successful conclusion of the UNCED meeting, which is to feature not only climate change concerns but a broad range of environment and sustainable development topics (see below).

Japan's suggested list of areas of cooperation also refers to protection of endangered species, an issue over which U.S. officials have threatened trade sanctions in the past year in a bid to force Tokyo to agree to honor terms of the Conference on International Trade in Endangered Species and to accept a moratorium on the use of large drift nets in international waters. Whether this item was included to show how much Tokyo had compromised on environmental issues with the United States in the past year remains unclear.

Another potentially painful area of cooperation proposed by Japan -- preservation of tropical rain forests -- raises a question of how successful that country thinks new official and corporate environmental policies will be in countering international criticism that Japan's construction habits have contributed to the despoiling of tropical forests. Other issues proposed for cooperation are less

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contentious: prevention of natural disasters, surveys on global changes, and joint projects involving the Japan Overseas Cooperation Volunteers and the Peace Corps.

The latter notion most likely will resurface at a mid-January meeting in Hawaii between American and Japanese officials involved in foreign aid. The agenda at that meeting includes possible cooperation in creating a network of environmental resource centers in developing countries. Initially these centers would focus on domestic environmental goals; later their mission would include regional projects. Japan already has worked to create sectorally affiliated resource centers in various countries through the Japan International Cooperation Agency (see Table 1). A U.S. proposal features a two-year study to look at these and other existing centers to make sure that the proposed resource bases would not be duplicative. Funding for four initial centers is eyed at 50-50, with each side chipping in a $100 million start-up contribution.

Cooperation already is proceeding at both the government and the nongovernment levels to monitor global climate change and to develop solutions. One of the latest tie-ups features participation by Japanese researchers in a monitoring project that began in September to assess the output of carbon dioxide and nitrogen dioxide in the East Asia region. An airplane contributed by this country's National Aeronautics and Space Administration plus one chartered by Japan's Institute for Environmental Studies will try to determine the output and diffusion of CO_2, NO_2, sulfur dioxide, methane and chlorofluorocarbons, gases thought to contribute to climate change -- the greenhouse effect -- by warming earth's lower atmosphere.

A panel coordinated by the World Resources Institute, a Washington, D.C.-based nongovernmental organization, is conducting parallel studies with the Global Industrial and Social Progress Research Institute, which is affiliated with the Ministry of International Trade and Industry, on how to accelerate the diffusion of environmentally sound technologies to developing countries. Cross-membership on each country's panel of academics, business representatives and environmental analysts helps to keep both groups informed of the other's efforts prior to joint analysis of the findings. American participants have suggested that private-sector involvement might help surmount U.S. institutional suspicions about the trade impact of shared information. In return, they have indicated, their Japanese counterparts might benefit from learning more of the ins and outs of international political follow-through.[1]

At the legislative level representatives of the Diet routinely meet with members of Congress and their European counterparts under the auspices of the Global Legislators' Organization for a Balanced Environment. GLOBE reviews similarities and differences in the respective countries on environmental issues and has as one goal the coordination of approaches to international problems. An early February meeting in Washington will feature Japanese-proposed discussions of financial mechanisms that might encourage developing countries to pursue sustainable development. Among the ideas to be covered are environmental taxes, debt-for-nature swaps, and foreign aid, both multilaterial and bilateral. U.S. legislators have proposed talks on the inclusion of natural resource and environmental costs in accounting methods. Other topics will deal with propping up environmental financing through arms reduction and the issues to be addressed by the June UNCED meeting.

These examples of cooperation and Japan's record of energy efficiency are two reasons Japan is losing its outlaw image when compared environmentally with other countries. The irony has not been lost on some environmentalists familiar with Japan. Richard Forrest of the National Wildlife Federation, who wrote a critical 1989 study *Japanese Economic Assistance and The Environment: The Need for Reform,* commented recently, "There's definitely a consensus by people who are watching the international environmental scene. . . . People seemed to think Japan was the worst but about a year ago it became clear that the balance had tipped. Japan is clearly not the worst. That's the United States."[2] Although Mr. Forrest acknowledges that Japan's taking of more than 300 whales a year still angers environmentalists who fear depletion of whale species, he said that the broad picture -- one

Table 1: **Selected Environment-Linked Programs Funded By Japan's Foreign Aid**

	Training in Japan	Dispatch of Experts	JOCV*	Package Projects**	Feasibility Survey	Grant Aid
Forestry Protection			(2)		Tunisia Colombia Liberia Bolivia	
Forestry Industry	Community forestry (13) Agroforestry (15) Management technology (17) Soil/erosion (5) Forest product research (11)	Indonesia (1) Qatar (1) Yemen (2) U.A.E. (6) Senegal (1) Tanzania (2) Chile (1) Uruguay (2)	(11) to replant (20) in forest management	Brunei Indonesia (2) Malaysia (2) Philippines Thailand Kenya Paraguay Papua New Guinea China Brazil	Uruguay management five-year plan	
Sea pollution Prevention	Marine protection (4)	Indonesia (1)			U.A.E. study of marine pollution	
Subterranean Water Development		China (2) Indonesia (2) Pakistan (6) Madagascar (2)	(2)		Bhutan China Nepal Philippines (2) Egypt Jordan Madagascar Nigeria Dominica Honduras	India Pakistan Zaire Central Africa Malawi Bolivia
Water Resource Protection	River and dam institute (10)	Malaysia (1)				
Disaster Prevention	Calamity response seminars (43) Volcanology school (14)	Cook Islands (5) Indonesia (9) Philippines (4) Singapore (1) Algeria (3) Egypt (3) Zaire (3) Brazil (1) Colombia ((2) Costa Rica (2) Honduras ((1) Peru (1) Venezuela (8) ESCAP Thailand (1)		Indonesia volcano, erosion protection Peru/Japan 'quake response center Mexico earthquake response center	South Korea river protection plan Philippines traffic plan for disasters Mauritius landslide protection plan Brazil flood control project Venezuela river conservation plan	Pakistan weather observation network Nepal flood protection Maldives shoreline preservation
Living Environment (sewer, water systems)		Philippines (1) Peru (1) Nepal (3)			Bangladesh China Laos Malaysia (2) Philippines (3) Brazil	Philippines Manila flood control plan Bangladesh storm water control plan Honduras downstream development plan

*Japan Overseas Cooperation Volunteers

**Package projects include a mixture of grants and technical assistance to help establish a research center.

Source: Japan International Cooperation Agency that takes into account America's use of approximately 25 percent of the world's energy supplies for nearly 5 percent of the world's population -- has revised the perspective on Japan's overall environmental practices. At some of the significant environmental conferences this year Japan will continue to be portrayed as part of the problem and at others as part of the solution.

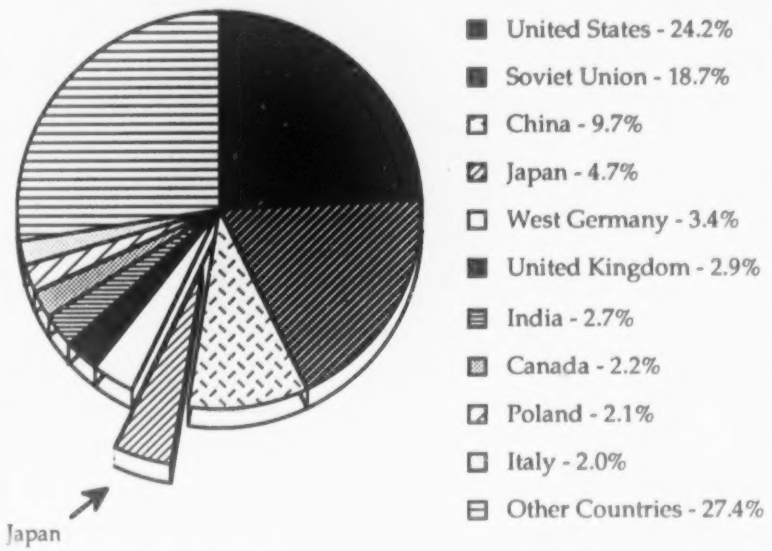
Japan as Host for CITES Meeting - Japan's exceptions to generally accepted global norms against trade in or hunting of certain species, such as whales and some types of sea turtles, have come under much criticism from environmentalists.[3] For this reason the desire to serve as host of a meeting of the Conference on International Trade in Endangered Species would seem masochistic unless a country has an alternative agenda or wants to underscore evidence of change. Either is possible in the case of Japan, which will serve as host for a CITES meeting in Kyoto in March.

At various recent environmental regional conferences Japanese officials have expressed an interest in protecting the sovereign rights of developing countries, which contend that global environmental concerns often represent industrialized countries' interference in their domestic affairs. At the March CITES meeting some developing countries in Africa are expected to push for fewer limits on the trade in ivory, which was placed on the most restrictive CITES list (Appendix I) at an October 1989 meeting. These countries contend that their work to protect elephants from poachers who were decimating herds elsewhere in Africa should not be punished by disallowing their sale of ivory from selectively culled animals, particularly since sales are used to reinforce protection programs. Although Tokyo voted for the Appendix I listing, some observers have suggested that the vote was a factor in Japan's bid to serve as host of the 1992 CITES meeting and not a statement of principle.

The upcoming meeting will give Tokyo a chance to weigh the sovereignty issues of developing countries as well as to reconsider the import ban's effect on traditional ivory craft workers in Japan, who are running low on their pre-1990 stockpiles. Japan's resulting vote could point to how Tokyo plans to respond to calls for biodiversity -- the preservation of various species, a concept that will be discussed at the UNCED gathering -- if the general theory appears to contrast with specific developing country efforts at sustainable development.

The CITES meeting also could underscore recent steps Tokyo has taken toward subjugating self-interest to global concerns. Under pressure from the United States and world opinion Tokyo reluctantly agreed last year to discontinue trade in two endangered species of sea turtles, the hawksbill and the olive Ridley (see *JEI Report* No. 24B, June 28, 1991), and worked out a plan with the United States to endorse a worldwide moratorium on drift-net fishing (see *JEI Report* No. 45B, December 6, 1991). In both cases Tokyo opted to provide subsidies for such purposes as vocational training and low-interest loans for those looking for new jobs or interested in starting a new business. Threatened U.S. sanctions showed the effectiveness of *gaiatsu*, outside pressure, on environmental matters. U.S. observers contend that *gaiatsu* in general has been most effective when Japanese officials need an external reason to accomplish changes they consider necessary or inevitable.

Differing Approaches to UNCED - Tokyo at least indirectly has considered whether reverse *gaiatsu* would be effective in moving U.S. officials toward an international agreement to set targets aimed at reducing emissions of gases thought to contribute to climate change. A climate change convention containing such targets is one of the goals of the UNCED meeting in early June in Rio de Janeiro, Brazil. Washington remains the sole major industrialized country objecting to targets for carbon dioxide emissions, of which the United States is the main global contributor (see Graph). Initially Tokyo had stood beside the White House in its resistance to targets limiting CO_2 emissions and its call for more scientific evidence that climate change causes harm. But after a late summer 1990 report by the U.N.-sponsored International Panel on Climate Change warned that global mean temperatures could warm by 3 degrees Celsius in the next century, Tokyo decided that the potential harm was sufficient to act. Plus, Japanese leaders weighed European leaders' calls for emissions targets and confidently concluded their country was technologically capable of at least stabilizing



C02 Emission by Countries, 1988

Source: Japan Environment Agency

emissions. In October 1990 Tokyo adopted a plan that calls for per-capita CO_2 emissions in the year 2000 not to surpass 1990 levels, with a gradual reduction, if possible, of the country's aggregate CO_2 output to 1990's level of 300 million tons (see *JEI Report* No. 42B, November 2, 1990).

In a discussion last year about the Bush administration's reluctance to adopt a CO_2 emissions target then Environment Agency director general Kazuo Aichi commented, "I think that since the United States is emitting 24 percent of the world's carbon dioxide gas at this moment there is no way for us [Japan] to stabilize or prevent global warming without action by the United States. So one of the concerns at this moment is how we can get the United States seriously involved. . . . One way is to put some *gaiatsu* on the United States."[4] Other Japanese officials and observers are making similar comments, putting the burden on the United States as the world's largest contributor to CO_2 emissions and one of the biggest per-capita users of energy to commit to an agreement on climate change. An American environmentalist recently wrote in the *Washington Post*: "The general opinion is that unless the United States changes course or the conference's adroit chairman -- Canadian Maurice Strong -- is able to pull a rabbit out of a hat, UNCED will end in a North-South standoff. Blame for this is being placed on Washington."[5]

In what some observers have considered a move to win U.S. compliance for a climate change agreement MITI offered a plan in mid-1991 suggesting that each nation independently pledge to stabilize or reduce emissions at whatever level its leaders feel can be achieved. Compliance with this pledge then would be voluntary and would be reviewed by an international panel, relying on world opinion to achieve follow-through. The "pledge and review" proposal became controversial in Japanese government circles; officials of other agencies worried that MITI -- hesitant to commit Japanese industry to a target of reducing CO_2 net emissions to 1990 levels or below -- had weakened the government's 1990 proposal by pushing the "pledge and review" concept internationally. The "pledge and review" proposal reportedly now is considered by the government to be part of a domestic target and timetable plan, although the Ministry of Foreign Affairs will continue to put forward the voluntary "pledge and review" process for consideration by delegates negotiating the convention on climate change. U.S. officials have questioned whether Japan will back targets for CO_2 emission reductions if the "pledge and review" plan is not included.

One of the concerns of Japanese delegates at the climate change negotiations leading up to the June UNCED meeting is to avoid conditions that would force Japan to restrict emissions of greenhouse gases to the same degree as nations that are less energy efficient. As can be seen from Table 2, Japan's track record for emissions considered contributors to potential global warming is far superior to most other leading industrial nations. One consideration for decreasing worldwide levels would be to allow pollution trading permits that would be bought by countries with successful pollution control programs; the money then would be used to help a seriously polluting country achieve compliance. Such a plan would resolve another problem being considered at UNCED -- the financing of more impoverished countries that typically tackle industrial development through quicker-and-dirtier means than do countries with the technical and financial resources to invest in environmentally friendly processes.

Table 2: **Emissions Linked to Global Warming in Selected Countries**

	Carbon Dioxide	Nitrogen Oxides	Sulfur Oxides
(overall output in millions of metric tons: 1990)			
United States	1,433	19.5	20.7
Japan	272	1.2	0.8
West Germany	198	2.9	1.2
Great Britain	163	2.4	3.8
(kilograms per unit of $1,000 in gross domestic product: late 1980s)			
United States	324	4.5	4.7
Japan	181	0.8	0.6
West Germany	294	4.3	1.9
Great Britain	317	4.9	7.0
(in metric tons per person: late 1980s)			
United States	5.8	80.4	84.0
Japan	2.2	9.6	6.8
West Germany	3.2	46.7	21.3
Great Britain	2.9	44.0	63.1

Source: Organization for Economic Cooperation and Development

In preliminary UNCED discussions developing nations have stressed their related need for financial help and consideration of how the problems of poverty and population pressures affect a country's ability to look beyond immediate survival concerns to enable planning for sustainable development. Financing options are important for developing countries, not only to help them meet environmental concerns but in some cases to enable them to surmount international debt burdens so they can reach a point where they could consider investing in environmentally beneficial measures.

These elements are included within the main objectives of UNCED, which hopes to:

- Bring together countries that have drafted international conventions on climate change and biodiversity for final resolution and signing.

- Win approval of an Agenda 21, which will contain actions to be taken through the year 2000 and into the 21st century by countries, international agencies and the private sector to integrate environmental and economic concerns in a manner that promotes sustainable development. Among the suggested targets are the eradication of poverty and access by less fortunate peoples to sustainable livelihoods; the reversal of environmental destruction of renewable resources; and the implementation of a system of incentives and penalties to enforce ties between sustainable resource use and economic behavior.

- Develop a system of financing that will help developing countries achieve the goals of Agenda 21. Also under consideration is a revamping of development policies and economic indicators to incorporate environmental measures.

- Designate international institutions to carry out these plans and provide them with the authority or the financing to do so.

One of the other proposed conventions debated during pre-UNCED meetings would have outlined forest management objectives that encouraged biodiversity, preservation and sustainable development. Japan had been active in trying to win agreement on proposals for such a convention, but developing countries balked; they were concerned about their sovereignty being undermined and were frustrated over industrial countries' attempts to focus primarily on tropical forests instead of looking at practices in temperate and boreal regions as well. The implicit complaint was that industrial countries had no international restrictions in place when their temperate forests were being cut. Since forest management is one of the ways of handling climate change, the issue will continue to be discussed at UNCED.

As this ambitious schedule becomes weighed down by numerous concerns, the success of the conference may lie primarily in the number of countries that voluntarily adopt UNCED's proposals. Already the discussions generated by meetings leading up to the June UNCED forum have had an influence on planning by government and private sectors in Japan relating to both domestic and international environmental policies.

Post-UNCED Implementation Possibilities

Domestically Tokyo has taken a variety of measures aimed at reducing emissions of greenhouse gases and has beefed up its foreign aid program to advance environmental concerns in developing countries. The business community, too, has outlined ways in which the environment will gain from increased corporate attention. Japan's boardrooms have expressed a surprising degree of interest in environmental issues over the past two years or so. Some of this attention has brought forth not just study committees but actual recycling programs and new technologies that patent applicants or holders hope will have international market opportunities.

Comments from business as well as government leaders in the past year have indicated a recognition of an economic benefit to accounting for environmental concerns. In an address in Thailand to a July 1991 forum on business and environment sponsored by the Association of Southeast Asian Nations, for example, the president of Nissan summed up a story about how much cleanup and compensation damages had cost a Japanese polluter with the comment: ". . . I think one of the key perspectives of future business and industrial activities should be the concept that advance preservation of the environment is much more cost effective than trying to deal with a problem after it has occurred."[6]

While Yukata Kume's comments did not refer to the commercial benefits that stemmed from Japanese cars being some of the most energy efficient on the world market in the late 1970s and 1980s, Environment Agency official Saburo Kato told an interviewer recently:

> There is no question that our strict regulations have made Japanese industries more competitive. To conserve energy, for example, they had to develop more efficient production processes. When energy prices rose [in the

> 1970s], Japanese corporations were well-positioned: their products were far more price competitive than the industrial countries that lacked strict pollution controls. But even more important, Japan's environmental regulations were ahead of their time. When other countries adopted similar environmental regulations, such as auto emission standards, Japanese products already satisfied many of them. For example, Toyota and Nissan were ready to export fuel-efficient cars, while their foreign competitors were forced to make costly and abrupt adjustments in their industries. The same should occur with Japan's strict controls on greenhouse gas emissions.[7]

The energy efficiency and air pollution regulations that have won Japan kudos from environmentalists make compliance with new percentage-reduction requirements difficult, however. Many actions already have been taken, and energy use is up while efficiency -- judged by energy consumption per unit of gross national product -- is down (see *JEI Report* No. 23A, June 21, 1991). Moreover, a projected increase in electricity demand of between 2.5 and 3 percent a year over the next decade has sent Japanese utility planners to the drawing boards to come up with a 40 percent increase in generating capacity. Although more nuclear power plants -- considered benign in terms of global warming -- could help Japan meet its emission stabilization target and still provide for enhanced lifestyles and productivity, public resistance remains high.

Another concern of environmental officials is the increased number of motor vehicles on Japanese roads. New diesel emissions restrictions and an emphasis on electric or nongasoline-powered cars and trucks point to Japan's use of both regulatory and administrative guidance to reduce the output of carbon dioxide and nitrogen oxide.

Government-Generated Domestic Measures - Among the various ways Tokyo hopes to achieve stabilization of greenhouse gas emissions are: increased funding for research into alternative energy sources, plus energy-efficient and emissions-control technologies; new recycling legislation; and plans that, if implemented, could touch on almost every phase of life in Japan. An environmental tax of some kind also is under consideration.

- Research and Development - The draft budget for fiscal year 1992 contains Y39.9 billion ($295.6 million at Y135=$1.00) for developing new energy sources that would lessen Japan's use of petroleum products. That amount is up 5.2 percent from the current fiscal year and will be used, among other projects, for further work on solar generators and fuel cells. Regulations are being developed to allow solar energy producers to interface more easily with electric utility operators.

Many industries benefit directly or indirectly from government R&D assistance for environment-related science projects, which in FY 1991 received more than Y438.3 billion ($3.3 billion) in funding (see *JEI Report* No. 36A, September 27, 1991). Among those projects is one to find alternatives to chlorofluorocarbons, a greenhouse gas that Japan and most other industrialized countries have agreed to phase out by the end of 1999. Most Japanese companies using CFCs already are far along in development of alternatives or equipment that could operate with alternatives; automotive manufacturers, for example, expect to quit using CFCs in car air conditioners by 1996.

- Recycling - Not only does legislation passed in 1991 aim at stemming the flow of waste to Japan's rapidly filling landfills (see *JEI Report* No. 17B, May 3, 1991), but it could cut energy requirements by combining raw materials with recycled inputs for new products. In some cases, such as the manufacture of aluminum and steel, use of recycled materials can cut the cost of production. Companies that fail to adequately work at recycling now face a maximum fine of Y500,000 ($3,700), which, by itself, is minimal deterrence. More government control also is expected; local governments, for example, now will be legally responsible for overseeing the separation and the collection of recyclable throwaways.

After passage of the recycling law MITI assigned specific targets in October for two industries to increase their use of recycled materials and recommended that a third industry also boost its rate. By 1994 paper manufacturers are expected to increase by 5 percentage points the amount of recycled paper they add to raw materials for their products. Current paper production features a 50-50 ratio. Manufacturers of glass containers were told to incorporate 55 percent recycled material into their products by fiscal 1994, up from 1989's ratio of 48 percent. Also urged to boost its use of recycled sand, concrete, asphalt and dirt was the construction industry, now averaging about a 30 percent ratio of recyclable inputs. Environment Agency reports also have called for higher recycling rates to help separate recyclable matter from that headed for the landfill or incinerator.

This use of legislated targets is not as unusual as it might seem for a country more associated with its prodding of industry through "administrative guidance." Japan attained some of its current success in air quality management through hard-nosed government regulation plus tax incentives and government backing for research and development. In a 1991 report on the environment industry the Paris-based Organization for Economic Cooperation and Development noted that specific legislation drove demand in Japan in the 1970s and 1980s for flue-gas desulfurization equipment.[8] Legislation not only encompassed emissions standards but allowed those who suffered from pollution to sue suspected polluting industries for compensation (see *JEI Report* No. 9A, March 8, 1991).

- Other Recommendations - Among the more difficult goals to achieve might be those designed to realign Japan's transportation system to encourage more use of shipping and railroads rather than trucking (see *JEI Report* No. 19B, May 17, 1991). The Ministry of Construction's strong influence is expected to impede follow-through of a plan under development by the Ministry of Transport to shift freight traffic from roads to more energy-efficient trains and ships.

Another energy-efficiency proposal would encourage the transformation of all Japan's 24-hour-a-day incinerators into cogeneration facilities that would have a combined generating capacity of 2.5 million kilowatts. As recommended by a panel affiliated with the Ministry of Health and Welfare the measure would result in estimated savings of 110,000 kiloliters of crude oil annually, equivalent to about a 4 million-ton reduction in CO_2 emissions. The recommendation would mean upgrading 295 of the 397 full-time incinerators since those currently do not produce electricity as a by-product. A study by Boston, Massachusetts-based Charles River Associates noted that although Japan has almost six times the number of incinerators that America has, their total electricity output is nearly seven times lower.[9] Other sources of wasted heat that the Environment Agency has said might be tapped in the future are subway systems and wastewater treatment plants.

Agriculture's high use of nitrogen-based fertilizers in Japan -- 15 tons per square kilometer compared to this country's figure of 5.5 tons, according to OECD calculations for 1988 -- also could face constraints in the future from the double whammy of concern over global warming and water pollution fears. Ways to decrease the production of methane are being studied as part of Japan's October 1990 "Action Plan to Arrest Global Warming," which calls for methane emissions to be stabilized at 1990 levels. Increased planting of carbon dioxide-absorbing greenery additionally counts as one of the ways Japan hopes to counter global warming.

- Taxes - The Ministry of Finance in cooperation with the Environment Agency reportedly began studying early last year various fuel, lumber import and industrial waste taxes as ways to alter behaviors tied to global warming. If imposed, the proceeds from such an environmental tax would go toward financing Japan's commitments to UNCED and its own international activities aimed at preventing global warming. Consideration of some type of environmental tax followed an agreement made at a January 1991 meeting of environmental officials of OECD countries.

Discussion of the tax comes amid a general MOF review of Japan's tax system, but the likelihood of its imposition is growing slimmer with the advent of more pressing demands (see *JEI*

Report No. 1B, January 10, 1992). Moreover, if UNCED participants fail to achieve agreement on financial incentives, Japan is unlikely to do more than expand slightly its current commitments. Japanese business leaders also have protested that the tax would be an extra burden; they have suggested that their efforts in technology transfers be weighed as an alternative way of helping developing countries.

Business Activities - A global environmental charter and a 10-point list of guidelines for Japanese companies with offshore operations has put Keidanren (Japan Federation of Economic Organizations) at the forefront of persuading the business community of the benefits of incorporating environmental measures into corporate thinking. In the past two years or so Japanese corporations also have become more interested in smoothing relations with Americans through increased attention to corporate giving. These factors, plus internal staff interest, also coincided with the Japanese government's vow to take a lead in international environmental issues.

Most of the attention focused on the environment is linked to business activities and not to philanthropy in a general sense. "The whole role of corporate philanthropy is very new in Japan," notes Lori Forman, who, as a representative of The Nature Conservancy, has made presentations to Keidanren on possible conservation steps that corporations could take. "They want some kind of formula [for example, donations tied to paper consumption or fleet consumption of gasoline] to link their donations to. The idea of just giving to help is not as well-founded."[10]

In its global environmental charter the powerful business organization stresses the ethics and conservation payoffs of responding to environmental issues. Keidanren also has set up a study team to review various conservation ideas, including debt-for-nature swaps. And, while not bannered as a prime reason behind corporate environmental concerns, no doubt the increased marketability of environmentally correct services and products is a welcomed benefit.

- Keidanren Environmental Charter and Guidelines - Released in April 1991 Keidanren's charter mirrors UNCED concerns, stating in part:

> The task before us is not merely one of rethinking the problems caused by the pursuit of affluence in a culture that encourages mass consumption; we must also come to grips with the global problems of poverty and population increase, aiming to hand over to future generations a healthy environment that allows sustainable development on a global scale. . . . We must aim to construct a society whose members cooperate together on environmental problems, a society where sustainable development on a global scale is possible, where companies enjoy a relationship of mutual trust with local citizens and consumers, and where they vigorously and freely develop their operations while preserving the environment. Each company must aim at being a good global corporate citizen, recognizing that grappling with environmental problems is essential to its own existence and its activities.[11]

Among the charter's recommendations are that companies: work to protect the environment and conserve resources; ensure their products' environmental soundness so that workers' and consumers' safety and health are protected; institute internal methods for handling environmental issues and establish companywide environmental regulations; incorporate environmental impact assessments of some type for new sites and procedures; consider downstream recycling potential when purchasing or planning products; develop technologies and services in tune with environmental conservation; develop ways to transfer technologies and know-how overseas to further the spread of environmental preservation; acknowledge problems and act to minimize their impact, including in cases occurring outside the company's responsibility; work to educate employees and the public on environmental issues and activities; and encourage employee and corporate contributions to community and public activities that enhance the environment.

The 10 environmental guidelines for overseas operations, introduced in 1990 with a document outlining Keidanren's *Basic Views of Global Environmental Problems* and later attached to the charter, state that companies should: have a constructive attitute toward environmental protection and be willing to fully explore issues with concerned parties; at a minimum obey environmental standards of the host country but also apply Japanese standards in managing hazardous materials; conduct complete environmental assessments before starting an activity overseas; work with local parties at the site of operations and cooperate in transferring environment-related technologies and expertise; set up an environmental management system with a person in charge, one preferably who has been trained for the job; routinely inform local citizenry about environmental issues at the site; deal with environment-related controversies by paying attention to social and cultural concerns but maintaining a scientific and rational manner; cooperate in promoting the host country's scientific environmental approaches; publicize at home and overseas the corporation's environmental activities; and work with headquarters to increase understanding of local environmental concerns. The home office also is urged to set up a support system of experts who could be dispatched to overseas locations to help solve environmental problems.

To emphasize that its interest in the environment is more than skin deep, Keidanren recently surveyed major industries to monitor implementation of environmentally linked suggestions (see Table 3). This interest, however, does not mean that Keidanren has lost its economic soul. Mention of increased taxes for global international concerns, such as the environment, still has the power to raise hackles in Keidanren's boardroom.

- Debt-for-Nature Swaps - Although the benefits of debt-for-nature swaps have been questioned on many fronts, including in a recent study by the General Accounting Office,[12] the concept continues to be studied as a method of relieving a developing country of some of its debt burden while at the same time contributing to environmental conservation in that country. Bank of Tokyo, Ltd. became the first Japanese corporation to fund a debt-for-nature swap when it agreed last summer to extend $1 million to the World Wildlife Fund, which would handle the purchase of discounted developing country debt and the setting up of environmentally beneficial programs with the proceeds. The first outlay of $200,000 was earmarked for environmental programs, such as the preservation of forests and coral reef, in the Philippines. The remaining $800,000 is expected to be used on conservation projects in Latin America.

Taking another tack is the Public Trust Fund for Conservation of the Global Environment, set up by seven trust banks, led by Mitsui Trust & Banking Corp., and joined by Daiwa Bank, Ltd. Money from the trust, funded at an initial level of $144,000, will be used for tree-planting and other projects in Latin America and Southeast Asia. The Japanese owner of the 7-Eleven franchise, Ito-Yokado Co., Ltd., boosted the fund by half with its subsequent contribution of $72,000.

Whether through opportunities generated by Japan's foreign aid program (see below), trade incentives or an attempt to improve their "green" image, Japanese firms have tackled a variety of environmentally related projects overseas. These programs are not necessarily considered preservation or conservation attempts by environmentalists. Examples of controversial activities include Nissho Iwai Corp.'s plan to work with a Brazilian development company and paper and pulp manufacturers to plant eucalyptus trees in an Amazon River basin; half the trees would be cut for production, although the remainder would be kept for a natural forest. Similarly, a Mitsubishi Corp. reforestation project undertaken with Yokohama National University and a Malaysian university may not entirely wipe out criticism of the trading company for what some environmentalists contend is its support for indiscriminate logging of Malaysian tropical forests. In the drier but less controversial climate of the Sahara desert five Japanese firms hope to establish a greenbelt area that can be cultivated. Undertaking a feasibility study of the project, estimated to cost Y90 billion ($666.7 million), are Shimizu Corp., Taisei Corp. and Obayashi Corp.; these big contractors would receive support on solar battery technology from Tonen Corp. and irrigation know-how from Kubota Corp.

Table 3: **Environmental Planning and Implementation Efforts in Industry**

Electric Utilities	Increased recycling of coal ash planned; about 58 percent now is recycled. R&D looking at using coal ash for cement, fertilizer. Encouragement of municipal use of cogeneration systems by providing technical assistance and arranging to buy excess generated electricity.
Oil	Studying how to refine crude oil and trying to determine how much energy is wasted in the process.
Steel	Continued research into energy-efficient processing; currently over 90 percent of slag and 95 percent of coal dust is recycled.
Nonferrous Metals	Continue using waste material from other industries for inputs. Make slag into materials for concrete.
Chemicals	Set up a study group that is looking into recycling methods and more energy-efficient processes.
Paper	Continued efforts to recycle high-quality paper. Will increase the percent of recycled paper used in producing new paper products from 50 to 55 percent.
Automotive	Setting up a Japan Automobile Manufacturers Association task force to design processes that reduce waste in production. Cooperating with municipalities to collect abandoned cars. Introducing a system that requires dealers to take back used vehicles from owners who want to get rid of them.
Electric Machinery	Task force formed to examine cooperation among municipalities, appliance makers and distributors for accepting old appliances that otherwise would be thrown out. Pilot project is under way in Tokyo area neighborhoods. R&D into new types of appliances that are easier to repair so that buyers can retain them longer.
Batteries	Mercury batteries to be phased out.
Plastics	PET (polyethylene terephthalate) bottles being marked for recycling. New association studying styrofoam recycling.
Construction	Setting up intermediate recycling facility, with ultimate target of achieving 80 percent recycled waste materials. Encouraging construction sites not to mix materials to help in the recycling process.
Retail Stores	Manufacturers urged to produce more recyclable packaging. Compliance program to be introduced for recycling milk cartons, PET bottles, aluminum cans and trays. Guidelines to be expanded for recycling and collecting recyclable trays. Manufacturers to be urged to use safer, more recyclable materials for trays used to package 73 items that cannot be adapted to use for vegetable, fish or meat products. Considering a charge for shopping bags with refunds given for returned bags. Encouraging use of recycled paper and simplified wrapping of purchases.

Source: Keidanren, *Report of Keidanren Subcommittee on Recycling*, December 1991.

Development of this greenbelt could give a boost to Japan's environmental service industry, which so far has a relatively low profile in the world market (see Table 4). The $200-billion-a-year environmental products and services industry is projected to enjoy 5.5 percent annual growth, according to a 1991 OECD estimate. UNCED chairman Maurice Strong stressed the trade and competitiveness factors of environmental issues in a November 1991 *Newsweek* article in which he referred to MITI's 100-year action plan for decreasing Japan's CO_2 emissions as based on a premise "that the environment is going to be the driving force of the economy and the source of most new comparative advantage in industrial opportunity."[13]

Table 4: **Selected Environmental Trade* of OECD Countries, 1990**

	North America	Europe	Japan	Total OECD
Equipment	74%	76%	79%	76%
Water and Effluent Treatment	24	34	22	29
Waste Management	25	15	22	21
Air Quality Control	12	17	25	15
Other (noise, land remediation)	13	10	10	11
Services	26	24	21	24
Total	100	100	100	100

*Based on estimated share of value of production.

Source: Organization for Economic Cooperation and Development

Japan's current strength in this field rests on its air pollution control products, not surprising given its successes in this area. In overall terms the OECD has calculated that on a value basis Japan exports about 18 percent of its environmental equipment output but that import penetration is below 3 percent of consumption.[14]

International Measures and Foreign Aid - The initial FY 1992 general account budget includes a whopping 86.3 percent increase, to Y1.4 billion ($10.4 million), for Japan's Green Aid Plan, conceived to promote the transfer of environmental technologies to developing countries. The measure is part of a foreign aid budget that will be up 7.8 percent, even though total general account spending will rise only 2.7 percent (see *JEI Report* No. 1B, January 10, 1992). Another environment-related component of the foreign aid budget sets aside Y370 million ($2.7 million) to help assure that aid projects would have an environmental assessment before activities begin. Reports also indicate that the U.N. Environment Program will get Y2.5 billion ($18.5 million) in the upcoming fiscal year and the International Tropical Timber Organization Y1.3 billion ($9.6 million). Japan also contributes funds used by other multilateral forums, such as the Asian Development Bank, for environmental projects. Last summer the Foreign Ministry promised $1.5 million to UNCED, the second-largest pledge at that time next to Sweden's $3 million contribution. Tokyo unveiled its first large-scale program for environmental funding in 1989 when then Prime Minister Sosuke Uno announced a targeted three-year plan to commit Y300 billion ($2.2 billion) in foreign aid for environmental projects.

Tokyo considers foreign aid programs to be one of the main ways it can help developing countries achieve some of the goals being proposed for UNCED. Bilateral assistance to developing countries for environmentally linked projects -- such as pollution control, afforestation and forest conservation, urban sanitation, water resource development and disaster prevention -- totaled about Y22.7 billion ($168.2 million) in grants and Y92 billion ($681.5 million) in loans in FY 1989. As part of its technical assistance program approximately 300 trainees were brought to Japan that year, while roughly 150 Japanese experts were sent to projects abroad. This training was in addition to that provided by the Japanese Overseas Cooperation Volunteers. (For an overview of Japan's foreign aid program, see *JEI Report* No. 45A, December 6, 1991.)

Not all this assistance has won plaudits from environmentalists, however. In response to past criticism that various Japanese aid programs had a harmful effect on the environment the Foreign Ministry last year adopted new guidelines calling for more attention to possible environmental problems when a project is being considered for funding, including potential adverse impacts on indigenous peoples and others living near a proposed project site. Specific guidelines drafted by the Japan International Cooperation Agency already call for attention to environmental concerns on dam construction; the Foreign Ministry's new references deal with road building, agricultural development and construction of power plants. As of this year projects will be checked to determine possible damages to historic sites as well as the environment and public health. The new guidelines also advise aid officials to take a more skeptical look at projects requested by developing countries and will ask for revision of items expected to cause environmental problems. Future guidelines will address railroad, airport and harbor projects as well as water supply systems and gas pipelines.

An effort to go beyond Japan's current bilateral and multilateral assistance programs also is under way. Former Prime Minister Noboru Takeshita, named as a special adviser to the government for UNCED, has set up a wise men's conference, which will meet in mid-April in Tokyo. The main topic will be ways of providing financial assistance to developing countries to enable them to respond to UNCED measures. Among the invited participants are former British Prime Minister Margaret Thatcher, past World Bank presidents Robert McNamara and Barber Conable, Singapore's ex-Prime Minister Lee Kuan Yew and former West German Chancellor Willy Brandt. Under consideration is the feasibility of a new international financial organization that will stress developing countries' needs for sustainable development. According to rough estimates, $60 billion a year will be required for setting up successful sustainable development programs. Given the competing demands around the world for money, the wise men's conference may have trouble staying focused on environmental concerns.

Outlook

Even if UNCED does not result in treaties on climate change and biodiversity, the discussions generated in advance of the conference have prompted Japan and other nations to carry out internal audits of their ability to achieve reduced emissions of gases. Given recent increases in energy consumption worldwide, this exercise alone no doubt will result in beneficial changes.

To achieve even stabilized emissions of carbon dioxide in the face of continued economic growth Japan might have to take more drastic actions than the United States would, since Americans have yet to achieve Japan's energy efficiency levels. The results of incremental steps might not be apparent for several years, though, and during that time economic concerns could squelch needed investment in environmentally friendly processes and equipment unless the benefits of trade in such products and services begin to counterbalance routine economic concerns.

Ways of drawing more attention to the importance of the environment in terms of the economy also will be on the agenda at the June UNCED forum. The International Monetary Fund, the World Bank and the U.N. Statistics Office are studying ways to implement a revised system of national accounts; a proposal is expected for UNCED debate. Under consideration is a system for environmentally adjusted economic accounts, which would incorporate environmental costs into the calculations of a country's gross domestic product. Currently, most countries' methods of valuing their output of goods and services do not reflect environmental degradation but, conversely, count investment to counteract any environmental harm done. Japan, no exception, has shown a small degree of interest in this subject. Discussion of a revised national accounting system -- just like the debates that have gone into UNCED drafts for climate change and biodiversity conventions -- threaten a shake-up in the way the world is accustomed to operating. Such additions to the menu for a new world order, however, might end up being too much to contemplate this year.

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NOTES

[1] US/Japan Economic Agenda, "Agenda Initiates U.S.-Japan Energy and Environment Project," No. 11, March 1990.

[2] Interview with Richard Forrest, National Wildlife Federation, January 2, 1992, Washington, D.C.

[3] One such article in the September-October 1991 issue of the relatively mainstream environmental magazine *Audubon* by Ted Williams, "Japan Bashing Reconsidered," raked Japan over the coals for past and present practices regarding whales, sea turtles, drift-net fishing and trade in tropical hardwood. See also *JEI Reports* No. 10A, March 9, 1990, and No. 40B, October 25, 1991.

[4] Interview with former Environment Agency director general Kazuo Aichi, *Japan Economic Survey*, November 1991, pp. 6-11.

[5] Jessica Mathews, "Countdown to Earth Summit," *Washington Post*, December 6, 1991.

[6] Speech by Yutaka Kume to Regional Forum on Business and Environment of the Association of Southeast Asian Nations, Bangkok, Thailand, July 22, 1991.

[7] "Environmental Moves to Inspire," *EcoTrends*, published as an advertising supplement to *Nikkei Weekly*, December 14, 1991, p. 17.

[8] Organization for Economic Cooperation and Developmnent, *The OECD Environment Industry: Trends and Issues* (Paris, France: 1991).

[9] Robert Eller, "Plastics Recycling and Solid Waste Management in Japan," paper presented to the Modern Plastics Executive Forum, New York, New York, April 22, 1991.

[10] Telephone interview with Lori Forman of The Nature Conservancy, December 23, 1991.

[11] Keidanren Global Environmental Charter, April 23, 1991.

[12] In *Developing Country Debt: Debt Swaps for Development and Nature Provide Little Debt Relief* (Washington, D.C.: December 1991) the General Accounting Office noted that the amount of debt swapped by severely indebted countries did not quite reach 0.05 percent of their total debt and 0.15 percent of their commercial debt.

[13] "A Greener Global Economy," *Newsweek*, November 25, 1991, p. 54.

[14] OECD, *op. cit.*

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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JAPAN · ECONOMIC · INSTITUTE

JEI REPORT

A Two-Part Report: A and B

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Outlook For FY 1992 Reflects Caution

Two yearend events provided evidence that Washington's voice is heard clearly by Tokyo's macroeconomic policymakers. Two weeks before President Bush's visit to Japan and on the heels of a December 20 cut of 1 percentage point in the U.S. discount rate to 3.5 percent, the Bank of Japan announced a half-point reduction in the Japanese rate to 4.5 percent. The December 30 announcement, which took immediate effect, came nine days after the cabinet of Prime Minister Kiichi Miyazawa had approved an economic outlook for FY 1992 that arguably reflected the need to put the best face possible on Japan's external trade position, an approach apparently taken in the knowledge that Japan's large current account surplus inevitably would be a subject of January 7-10 talks between the American president and the Japanese leader.

Both actions, whether or not they were planned to do so, could make the president's trip go more smoothly. However, the still weakening Japanese economy would have provided sufficient rationale in itself for the BOJ action. The discount rate cut was designed as a signal to corporations that the central bank would do what was necessary to maintain a relatively easy monetary policy aimed at encouraging firms to borrow money for plant and equipment investment. Reportedly, the timing of the decrease partly was meant to influence corporate investment decisions that typically are made in January or February for the fiscal year that starts April 1.

Beyond its domestic impact the discount rate cut played well in Washington, too. Coming as it did after the German central bank hiked rates on the same day the Federal Reserve Board dropped rates, the BOJ action demonstrated that Tokyo is in Washington's camp concerning the desired direction in worldwide interest rates. Inasmuch as lower U.S. rates, by themselves, typically would lead to a weaker dollar as investors avoided dollar-denominated assets, the Japanese discount rate cut served to support the American currency; further drops in the U.S. discount rate, if deemed necessary by the Fed, would be less difficult in light of BOJ's move. In addition, lower interest rates presumably would pep up the Japanese economy, encouraging somewhat faster growth that could draw in more imports. Of course, lower Japanese rates put pressure on the yen, which makes it weaker than it otherwise would be and thereby limits the increase in Japanese imports. Tokyo and Washington independently may have judged, however, that -- with the yen close to an all-time high against the dollar -- a weak Japanese currency need not be a major concern.

Like the cut in the discount rate, the government's economic outlook for FY 1992 reflected a number of considerations. As in the past, the Ministry of Finance and the Ministry of International Trade and Industry reportedly disagreed over the projected growth of gross national product in the upcoming fiscal year. The estimate for an inflation-adjusted increase of 3.5 percent, a drop from an expected rate of 3.7 percent in FY 1991, was a compromise between MITI, which wanted a higher rate, and MOF (see Table). The external sector created a different sort of problem. The Economic Planning Agency, which has primary responsibility for formulating the outlook, reportedly argued for incorporating a relatively high estimate for the current account surplus but apparently lost out to MITI and MOF; the two ministries were said to be worried about the impact of such a projection just prior to President Bush's visit. As a result, Tokyo officially expects the current account surplus to equal $71 billion in FY 1992, a drop from an anticipated $72.5 billion in the current fiscal year. An assumed average exchange rate of Y130=$1.00 for FY 1992 implies that, in real terms, the declining external

Government's FY 1992 Outlook for Real Gross National Product

	Original FY 1991 Outlook	Revised FY 1991 Outlook	Initial FY 1992 Outlook
	(percentage change)		
Real Gross National Product	3.8%	3.7%	3.5%
Contribution of Domestic Demand	4.0	2.8	3.6
Contribution of External Demand	-0.2	0.8	-0.1
Nominal Gross National Product	5.5	5.5	5.0
Wholesale Prices	-0.1	-0.4	-0.2
Retail Prices	2.4	2.9	2.3
	(billions of dollars)		
Current Account Surplus	$30.0	$72.5	$71.0
Trade Surplus	56.0	98.5	96.5

Source: Economic Planning Agency

surplus will be a drag on GNP in the year starting April 1. That, in fact, is what Tokyo expects, but at the same time it sees domestic demand growing 3.6 percent, up from 2.8 percent in FY 1991.

The government's real GNP growth figure barely overlaps the range of 21 private-sector forecasts. Only the perennially optimistic Research Institute of the National Economy, which forecasts inflation-adjusted GNP growth at 4 percent and real capital spending up 5.2 percent, exceeds the government estimates of 3.5 percent and 4.5 percent, respectively. Dai-Ichi Kangyo Bank, Ltd. and Nomura Research Institute are the most pessimistic, with forecasts of 2.3 percent real overall growth and decreases in plant and equipment spending of 0.1 percent and 1 percent, respectively. Taking the average, business forecasters anticipate 3 percent real GNP growth and a 2.4 percent real increase in capital investment. Most surveyed institutions also envision greater growth in the current account imbalance than does the government, with a $77.4 billion surplus being the average projection. However, the most recent forecast among the 21 predictions, made December 18 by the respected Japan Economic Research Center, suggests that the current account surplus could come in at a whopping $105.5 billion in FY 1992, enough to establish a new record.

Economists outside Japan generally share the outlook of Japanese business forecasters. For example, the Organization for Economic Cooperation and Development predicted December 19 that real economic growth in calendar 1992 would equal 2.4 percent compared to an estimated 4.5 percent in 1991. It also projected that real plant and equipment spending would grow 2.4 percent against an estimated 7 percent increase in 1991 and that the current account surplus would equal $82 billion, up from an anticipated $70 billion in 1991. Such figures are not directly comparable to the Japanese forecasts; Japanese business economists' calendar year GNP projections generally are more conservative than their fiscal year ones. For example, Nomura Research Institute expects 2.3 percent real GNP growth in fiscal 1992 and 2 percent growth in calendar 1992. If either the OECD or Nomura is right about this year, Japan will end 1992 with the slowest rate of growth since the economy contracted 0.8 percent in 1974, the time of the first oil shock.

Douglas Ostrom

FY 1992 Spending Plan Tightly Targeted

The cabinet of Prime Minister Kiichi Miyazawa approved a trim general account budget for FY 1992 on December 28, one that reflects the smallest overall spending increase since FY 1987. Nonetheless, the blueprint targets specific items for substantial increases by reprogramming funds from other areas. Although the Ministry of Finance traditionally has hewed to an austere line on general account spending, lower-than-expected tax revenues in FY 1991 and similarly weak prospects for FY 1992 made clear to all government agencies the need for fiscal restraint. At the same time Tokyo's drive to play a larger role in global political and economic affairs pulled budget planners in the opposite direction.

At the start of the FY 1992 budget process in mid-1991 the cabinet of then Prime Minister Toshiki Kaifu approved an initial overall increase of 5.2 percent for general account outlays (see *JEI Report* No. 26B, July 12, 1991). The initial round of budget requests submitted in August amounted to an 8.3 percent gain (see *JEI Report* No. 34B, September 13, 1991). Since then, however, it has become clear that slower domestic economic growth is cutting revenues far more than expected (see *JEI Report* No. 41B, November 1, 1991), generating a rush to cut spending and to boost revenues (see following article). The tiny net addition of Y266 billion ($2 billion at Y135=$1.00) to FY 1991's general account, approved December 13 by the Diet, was the first concrete sign of Tokyo's budget distress. The tight revenue prospects became even clearer when the cabinet approved a modest 2.7 percent overall increase to Y72.2 trillion ($535 billion) in the initial general account budget for FY 1992.

By category, however, discretionary general account outlays show a 4.3 percent gain, which reflects healthy increases in some line items but large drops in others (see Table 1). Excluding the

Table 1: **Summary of General Account Outlays, FY 1991-FY 1992**

(in billions of yen)

	Initial FY 1991	Initial FY 1992	Change
Discretionary Items			
Social Security	Y12,212.8	12,737.4	4.3%
Education and Science	5,394.4	5,683.4	5.4
Pensions	1,808.4	1,783.9	-1.4
Defense	4,386.0	4,551.8	3.8
Economic Cooperation	845.9	905.1	7.0
Public Works	6,521.4	7,956.1	22.0
Disaster Reconstruction	68.2	68.2	0.0
Small Business Measures	195.0	195.6	0.3
Food Control Programs	373.2	342.1	-8.3
Energy Measures	592.1	631.3	6.6
Administration and Operations	4,354.1	4,577.3	7.5
Transfer of NTT Proceeds to Public Works	1,300.0	216.6	-83.3
Infrastructure Investment	135.0	0.0	-100.0
Reserves	150.0	350.0	133.3
Subtotal	38,336.5	39,998.8	4.3
Nondiscretionary Items			
Transfers to Local Governments	15,974.9	15,771.9	-1.3
Debt Service	16,036.0	16,447.3	2.5
Subtotal	32,010.9	32,219.2	0.7
Total	70,347.4	72,218.0	2.7

line item for reserves, public works expenditures lead the list of winners with a 22 percent increase, but this is deceptive, as explained below. Next in line with increases are administrative and operating costs (7.5 percent), economic cooperation (7 percent), energy measures (6.6 percent), education (5.4 percent), social security (4.3 percent) and defense (3.8 percent). The spending levels for economic cooperation and defense were particularly controversial due to the rapidly changing global situation (see articles in this issue).

Spending within each of these line items also indicates Tokyo's priorities. Funds for United Nations peacekeeping operations, for example, are up 20 percent at Y1.5 billion-plus ($11.5 million). Environmental programs also show gains; funds to transfer pollution control technology to developing countries will jump 86 percent to Y1.4 billion ($10.4 million). Social programs, such as home care for the elderly, nurses' training and child care for workers, enjoy solid gains. Funding for basic research at universities will go up 9.7 percent to Y64.6 billion ($478.5 million), and another 230 foreign students will be brought to Japan at the government's expense, making a total of 3,195 in FY 1992.

At the other end of the budget scale food control programs and pensions are being cut; two other categories show little change. More worrisome to budgeters in the long run are the elimination of the special Y135 billion ($1 billion) infrastructure investment allocation and the deep cut in the transfer of funds to public works from the sale of Nippon Telegraph and Telephone Corp. stock. By paring these two items, total public works spending in the general account budget shows only a 4.5 percent gain, much less than the 22 percent mentioned above. The breakdown of combined public works outlays in the general account, however, indicates solid gains almost across-the-board (see Table 2).

The depth of Tokyo's revenue predicament is highlighted by the reduction in transfers to local governments. Normally transfers are determined by a long-standing revenue-sharing formula (see *JEI Report* No. 41A, November 1, 1991), but the current lowering of revenue estimates made the central government desperate enough to risk a backlash by cutting this item 1.3 percent.

The Miyazawa government has not ignored the increasing number of voices both at home and abroad calling for fiscal stimulus to keep the economy growing, however. It approved a 10.9 percent gain in the Fiscal Investment and Loan Program, the second, capital budget (see Table 3).

Table 2: **FY 1992 Public Works Spending Plan***

(in billions of yen)

	Initial FY 1991	Initial FY 1992	Change
Flood Control	Y1,366.7	Y1,428.2	4.5%
Roads	2,198.8	2,300.0	4.6
Harbors and Airports	625.6	650.6	4.0
Housing	885.9	931.1	5.1
Water Supply and Sewers	1,269.8	1,340.9	5.6
Agricultural Projects	1,068.8	1,109.4	3.8
Other	12.3	12.9	4.8
Forestry Projects	207.4	219.0	5.6
Repayment of Interest-Free Loans	114.7	110.7	-3.6
Subtotal	7,753.8	8,102.7	4.5
Disaster Relief	68.2	68.2	0.0
Total	7,818.2	8,170.9	4.5

*Includes transfer of proceeds from the sale of government-owned shares of Nippon Telegraph and Telephone Corp. to the special account for public works.

Table 3: **Fiscal Investment and Loan Program Outlays, FY 1991-FY 1992**

(in billions of yen)

	Initial FY 1991		Initial FY 1992	
	Amount	Change	Amount	Change
Housing	Y9,474.5	13.3%	Y9,799.3	3.4%
Other Social Infrastructure	4,293.3	1.7	5,157.9	20.1
Welfare	1,026.1	20.4	1,109.7	8.1
Education	582.4	5.1	582.9	0.1
Small Business	4,494.5	3.6	4,830.1	7.5
Agriculture	908.2	3.7	907.9	-0.0
Land Conservation and Disaster Relief	330.6	0.6	374.0	13.1
Roads	2,983.2	10.5	3,375.3	13.1
Transportation and Communications	1,468.1	-36.3	2,230.4	51.9
Regional Development	709.0	3.9	824.6	16.3
Industry and Technology	937.7	17.7	965.6	3.0
Trade Promotion and Economic Cooperation	1,898.0	18.4	2,104.5	10.9
Capital Utilization	7,700.0	10.8	8,540.0	10.9
Total	36,805.6	6.5	40,802.2	10.9

Within the capital budget there are several standouts, such as transportation and communications (up 51.9 percent, mainly for airport and road improvements) and social infrastructure other than housing (rising 20.1 percent). As for FILP funding, the FY 1992 figures show a continued trend toward severing FILP's link to the general account through the Industrial Investment Special Account and decreased reliance on borrowed funds (see Table 4).

The final round of preparliamentary budget negotiations, which take place after MOF has submitted its draft budget but before the cabinet approves a budget for submission to the Diet, was somewhat unusual this cycle. Education clearly got the biggest absolute increase in funding but in terms of percentage change was fourth (at 1.3 percent), behind pensions (2.8 percent), economic cooperation (2.1 percent) and miscellaneous (1.9 percent). Despite Y100 billion ($740.7 million) in unallocated funds in MOF's draft budget, administrative expenses were cut by Y103 billion ($763 million) to provide further funding flexibility (see Table 5).

Table 4: **Fiscal Investment and Loan Program Revenues, FY 1991-FY 1992**

(in billions of yen)

	Initial FY 1991		Initial FY 1992	
	Amount	Change	Amount	Change
Industrial Investment Special Account	Y65.7	2.5%	Y58.1	-11.6%
Trust Fund Bureau Fund	29,134.9	2.4	33,489.1	14.9
Postal Savings	8,800.0	22.2	9,900.0	12.5
Pension Contributions	6,430.0	16.1	7,230.0	12.4
Other Revenues	13,904.9	-11.5	16,359.1	17.6
Postal Life Insurance Fund	6,305.0	4.1	6,055.0	-4.0
Government-Guaranteed Bonds and Borrowings	1,900.0	-5.0	1,800.0	-5.3
Total	37,405.6	2.3	41,402.2	10.7

Table 5: **Proposed and Approved Initial FY 1992 Discretionary Outlays**

(in billions of yen)

	Proposed	Approved	Change
Social Security	Y12,702.6	Y12,737.4	Y34.8
Education and Science	5,612.5	5,683.4	70.9
Pensions	1,734.8	1,783.9	49.1
Defense	4,536.9	4,551.8	14.9
Economic Cooperation	886.3	905.1	18.8
Public Works	7,956.1	7,956.1	0.0
Disaster Reconstruction	68.2	68.2	0.0
Small Business Measures	193.1	195.6	2.1
Food Control Programs	342.1	342.1	0.0
Energy Measures	619.3	631.3	12.0
Other	4,680.3	4,577.3	-103.0
Infrastructure Investment	0.0	0.0	0.0
Reserves	350.0	350.0	0.0
Unallocated Expenses	100.0	--	

MOF has employed the trick of "robbing Peter to pay Paul" in previous budgets, but falling revenue forecasts combined with increased domestic and international obligations have made the gap between Peters and Pauls much wider in the FY 1992 spending plan. Nevertheless, the government's spending decisions have not generated popular outcry; nor are they likely to encounter difficulties in the Diet. The same response may not apply to the revenue side of the picture.

Jon Choy

FY 1992 Revenue Plans Draw Fire

The ruling Liberal Democratic Party again is in hot water with constituents over tax policy. In FY 1987 and FY 1988 popular outcry against the LDP's proposal to introduce a 3 percent general consumption tax, combined with a political influence-peddling controversy, appeared to threaten the LDP's hold on power. While the furor over the consumption tax and the political scandal has died down, sluggish growth in tax revenues as a result of the slowing economy retrained a spotlight on tax policy as the government prepared its FY 1992 budget.

From FY 1988 through FY 1990 the Ministry of Finance enjoyed an embarrassment of revenue riches as real estate and stock markets boomed and corporations rang up record profits. The good times apparently are ending in FY 1991; all three "boomers" have experienced downturns. Compounding these developments is the general slowdown of domestic economic activity, which naturally translates into lower rates of tax revenue growth. Data on tax and stamp receipts for the latest three months of FY 1991 show that proceeds from the securities transaction tax lag the most (see Table 1); September 1991's receipts, in fact, amounted to only 46.9 percent of the amount collected during the same month of 1990. And, while this percentage rose to 76.3 percent for November, revenues from securities deals collected over the first eight months of FY 1991 (April-November) still amount to less than 57 percent of that collected over the same period of the prior fiscal year.

Of greater absolute importance are lagging corporate tax revenues. According to the initial budget figures for FY 1991, corporations were projected to account for 27.4 percent of total general account revenues. As FY 1991 has progressed, however, MOF analysts have grown increasingly concerned because corporate tax revenues are failing to meet expectations. Their worries reached a peak in September when figures showed a gap of almost 20 percent between receipts in the first half of this fiscal year and the comparable FY 1990 period. Although the year-to-date deficit shrank to just over 9 percent by November, MOF analysts now fear that corporate taxes for all of FY 1991 will be below the previous fiscal year's total.

Cumulative tax and stamp revenue figures through November were running just slightly under the levels of FY 1990; against the background of a slowing economy such a situation does not sound like a disaster. When compared to MOF's original FY 1991 projection of a 6.5 percent increase in tax and stamp revenues, however, the shortfall is stark. Even tax collections that were up as of November were performing below expectations. Personal income tax collections through November, for example, were up 5.7 percent over the same period in FY 1990 but well short of MOF's predicted 20 percent-plus expansion.

While forcing MOF to take an even tougher stance against increased aggregate spending in the upcoming fiscal year (see preceding article), the revenue shortfall is not the only force behind the appearance of a multitude of "revenue enhancement," or taxation, options. At home are calls for a more stimulative fiscal policy to keep the economy from slowing further. On the international front Tokyo faces expectations of a greater Japanese role in global affairs, and that naturally means spending more on foreign aid, collective security and other global problems, such as Third World debt and environmental protection.

Table 1: **Monthly Tax and Stamp Revenues, September-November 1991**

(percentage of revenues for same month of previous year
and of cumulative fiscal year revenues through that month)

	September		October		November	
	Month	Year	Month	Year	Month	Year
Direct Taxes						
Personal Income Taxes	102.4%	104.7%	105.8%	104.8%	111.2%	105.7%
Withheld	102.8	104.6	105.9	104.8	113.8	105.7
Self-Assessed	90.5	105.0	105.1	105.0	106.1	105.5
Corporate Income Taxes	103.5	80.1	94.9	82.5	98.4	90.9
Inheritance and Gift Tax	116.8	108.9	159.2	116.3	160.1	122.1
Indirect Taxes						
Consumption Tax	101.0	95.8	98.6	96.7	103.3	100.3
Liquor Tax	100.3	105.6	94.4	103.4	102.1	103.2
Tobacco Tax	103.3	103.5	98.1	96.7	100.3	102.2
Gasoline Tax	98.0	103.3	102.2	103.1	103.0	103.1
LPG Tax	96.4	98.3	97.5	98.2	94.2	97.5
Aviation Fuel Tax	108.3	107.0	104.9	106.6	109.4	107.0
Petroleum Tax	97.9	109.4	112.8	110.1	96.6	107.6
Bourse Tax	102.5	99.9	118.9	102.6	95.1	101.4
Securities Transaction Tax	46.9	51.1	77.4	54.4	76.3	56.8
Motor Vehicle Tonnage Tax	100.5	99.8	97.3	99.8	99.0	99.8
Customs Duty	110.8	105.4	112.5	106.8	110.0	107.3
Tonnage Due	99.9	104.7	97.5	103.6	100.4	103.2
Stamp Revenue	86.1	85.3	87.1	85.8	92.8	87.1
Total Tax and Stamp Revenue	100.9	97.7	102.5	98.4	102.7	99.7

Source: Ministry of Finance

Several proposals have surfaced to fund these diverse needs, including: imposing new taxes or raising the rates of existing levies to support an "international contribution" fund; extending beyond their planned FY 1991 life a surtax on corporate income taxes and a higher tax on gasoline -- imposed originally to fund Japan's contribution to the multinational coalition that liberated Kuwait from Iraqi occupation; maintaining the excise tax on cars and lightweight-trucks at 6 percent rather than dropping it to 3 percent in FY 1992 as originally planned; increasing the consumption tax rate from its current 3 percent level; and freeing earmarked tax revenues to fund general operations. (For more details, see *JEI Report* No. 46B, December 13, 1991.)

The "international contribution" fund -- proposed by key LDP officials seemingly on the spur of the moment in early December after the government's peacekeeping operations bill appeared doomed in the Diet's upper house -- was meant to bolster Tokyo's foreign aid program and allow Japan to participate more freely in multilateral actions as well as to respond quickly during an international crisis. The proposal went nowhere, however, in large part because the fund's proponents had not laid the groundwork. Moreover, the fund's Y1.3 trillion ($9.6 billion at Y135=$1.00) price tag became untenable as the depth of the revenue shortage grew apparent. Opposition to the other tax proposals also arose in many different corners. The LDP, however, has drawn up a compromise FY 1992 tax package for submission to the Diet. Included are:

- A 2.5 percent surcharge on corporate income tax payments over Y4 million ($29,600). The surcharge actually is identical to this fiscal year's special Persian Gulf War levy on corporate income taxes, but the threshold will be raised from Y3 million ($22,200).

- The existing excise tax on new cars and light trucks will be cut from 6 percent to 4.5 percent. The 6 percent rate was to drop to 3 percent -- the rate of the consumption tax, which replaced the commodity taxes on other products in FY 1989 -- on April 1. The LDP thus split the difference between those arguing for a continued 6 percent levy and those in favor of a 3 percent rate.

- No compensating cuts in personal and corporate income taxes will be made when a new land-holding tax goes into effect at the start of FY 1992. When the tax was approved last year the LDP pledged to consider offsetting tax reductions. Receipts from the new tax (estimated at Y200 billion -- $1.5 billion -- in FY 1992) will be considered general revenues rather than earmarked for land-price stabilization as originally planned.

- The tax credit for firms operating at a loss will be eliminated.

- Real estate inheritance taxes will be calculated on 80 percent of the property's assessed value, rather than the current 70 percent. An increase in the tax-exempt amount of inherited real estate plus lower tax rates will offset the burden from the change in the base calculation; real estate tax revenues are expected to be unaffected by these changes.

Several LDP-drafted tax provisions target foreign companies. Among them:

- Newly established Japanese subsidiaries of foreign firms will enjoy special lower corporate income tax rates.

- Interest paid on treasury bills to foreign firms will be tax-exempt.

- Foreign firms that borrow more than three times their capital from overseas sources will not be able to deduct all of their interest costs.

Despite these tax gymnastics, which are projected to generate an additional Y730 billion ($5.4 billion) or so in FY 1992, the government projects that tax and stamp receipts will increase only 1.2 percent in FY 1992 (see Table 2). Given this slim gain, Tokyo expects to borrow more to cover the widening gap between revenues and expenditures. After years of driving down new issues of government debt, MOF will borrow an extra Y1.9 trillion-plus ($14.1 billion) in FY 1992 than in the current fiscal year through the issuance of construction bonds. If the economy slows further and tax

Table 2: **Summary of General Account Revenue Estimates, FY 1991-FY 1992**

(in billions of yen)

	Initial FY 1991	Initial FY 1992	Change
Tax and Stamp Receipts	Y61,772.0	Y62,504.0	1.2%
Nontax Receipts	1,932.4	2,217.4	14.7
Proceeds from Sale of NTT Shares	1,300.0	216.6	-83.3
Bonds	5,343.0	7,280.0	36.3
Construction	5,343.0	7,280.0	36.3
Deficit-Financing	0.0	0.0	0.0
Total	70,347.4	72,218.0	2.7

Source: Ministry of Finance

receipts continue to lag below projections, more borrowing may be necessary. While many analysts inside and outside the government criticize the LDP's FY 1992 tax proposal as merely a Band-aid for fiscal policy, the ruling party has more than fiscal concerns in mind; upper house elections are slated for mid-1992. A political party that has held power for more than 40 years apparently adheres to the axiom that a party in power that raises taxes in an election year soon will be out of power.

Jon Choy

Foreign Aid Boosted In Japan's FY 1992 Budget

Although decreasing tax revenues impose strict limits on the FY 1992 budget, the plan approved by Prime Minister Kiichi Miyazawa's cabinet December 28 included a significant boost for official development assistance. The foreign aid budget is set at Y952.2 billion ($7.1 billion at Y135=$1.00), a 7.8 percent increase over the comparable FY 1991 number. Although the projected rise in foreign aid outlays is the lowest since FY 1988, it is more than double the increase set for the FY 1992 defense budget (see following article). That gain represented a compromise between the 10.1 percent boost originally sought by the Ministry of Foreign Affairs and the 5 percent increase proposed by the Ministry of Finance.

The boost in foreign aid spending at a time of limited increases in other types of expenditures reflects the growing recognition in recent years of Japan's international responsibilities, an issue that came to the forefront of the political agenda in 1991. Last year was marked by early criticisms of Japan's contributions to the Persian Gulf crisis, both in terms of initial offerings and the successive legislative delays that prevented enactment of a bill that would have allowed Self-Defense Forces personnel to be dispatched abroad to assist United Nations-sponsored peacekeeping operations (see JEI Report No. 47B, December 20, 1991). The mid-December demise of a proposal to introduce new taxes or increase rates on existing levies to fund international contributions (see preceding article) further stymied efforts by successive prime ministers to give Japan a more active role in world affairs.

Following agreement on the 7.8 percent ODA rise, Foreign Minister Michio Watanabe indicated that the increase would enable Tokyo to meet its 1988-92 target of disbursing $50 billion in official development assistance. Current Japanese government estimates place aid disbursements between 1988 and 1990 at $27.3 billion, however, leaving some analysts skeptical that Tokyo can reach its target in the remaining two years of the fourth medium-term plan; even a dramatic appreciation of the yen against the dollar might not be quite sufficient, they calculate.

Of the Y952.2 billion ($7.1 billion) authorized for foreign aid in the upcoming fiscal year, Y905.1 billion ($6.7 billion) is under the economic cooperation line item in the general account budget; the remainder is included in other general account line items. These funds will be augmented by money from the Fiscal Investment and Loan Program, a second, capital budget.

According to Japanese news reports, Y227.8 billion ($1.7 billion) of the FY 1992 ODA budget will be used for bilateral grants, 7.2 percent more than budgeted for the current fiscal year. Japanese government officials reportedly attribute the increase in this category to new economic assistance needs for such countries as Cambodia and Vietnam. Of the bilateral-grant figure Y185.5 billion ($1.4 billion) will be directed to the poorest of the developing nations. The budget also includes Y1.5 billion-plus ($11.5 million) for United Nations peacekeeping operations, an increase of 20 percent over this fiscal year, which ends March 30.

The FY 1992 budget addresses one frequently cited weakness of Japan's foreign aid program -- the shortage of trained aid experts -- by increasing the number of Japanese to be dispatched abroad by 65, bringing the total to 1,884. It also will expand the total number of participants in the Japan International Cooperation Agency's overseas volunteer program by 30 and provide technical training in Japan for an additional 250 individuals from developing countries, bringing the number of foreign trainees to 6,620.

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Global Politics Take Backseat To Trade Frictions At Bush-Miyazawa Summit

Judging by op-ed articles and television commentaries in both the American and Japanese media, the January 8 and 9 meetings between President Bush and Prime Minister Kiichi Miyazawa in Japan may be viewed by historians as a case where domestic politics forced the "foreign policy president" to swerve off the diplomatic high road. When preparations for a planned late November summit began last year working-level officials in both Washington and Tokyo spoke in an upbeat manner about the meeting. The first state visit to Japan by an American president since former President Ronald Reagan's November 1983 trip would spotlight the potential for bilateral cooperation in tackling the myriad problems of a changing international order, they felt. The White House's decision in early November to postpone this trip signaled a change from a summit of "high politics" with America's most important Asian ally to one imbued with upcoming election year political pressures (see *JEI Report* No. 43B, November 15, 1991).

As portrayed by the media the Bush-Miyazawa meetings, rescheduled for January, became a glorified round of trade negotiations that may have created more political problems -- for Mr. Bush, in particular -- than they apparently set out to solve. Perhaps even more troubling is the prospect that the January 7-10 Japan leg of Mr. Bush's 12-day Asian trip may have undermined the original aim of fostering a spirit of goodwill and cementing ties between Washington and Tokyo.

While Michigan Democrats were among the most vocal critics on Capitol Hill, they were not alone in criticizing the president's efforts in Japan. Sen. Lloyd Bentsen (D, Texas), chairman of the Senate Committee on Finance, characterized the tour as "obviously a political trip to assist [Mr. Bush] in his reelection campaign." He added that his committee would hold hearings in late January to review the agreed-upon trade concessions, which he called "too little, 10 years too late." Rep. Gephardt cautioned: "While the president sent the right message to the Japanese people about the pivotal role of economics in our bilateral relationship . . . what really matters is whether we get results."

Several candidates for the Democratic and Republican presidential nomination also derided President Bush's approach to Tokyo and framed it as another example of what they characterize as the administration's poor handling of this country's economic problems. Conservative commentator and candidate for the Republican presidential nomination Patrick Buchanan labeled the trade concessions agreed to in Tokyo "puny and piddling," while Democratic candidates, including Arkansas Gov. Bill Clinton and Sen. Robert Kerrey (D, Neb.), accused President Bush of putting the United States in the position of begging Japan for favors.

As this country's economic problems loom larger for many Americans, Washington watchers note that the Bush administration's trade policies toward Japan are seen as an area of real vulnerability for the president. Congressional observers contend that Democrats will be quick to challenge the administration in this arena. The 1992 predictions on Capitol Hill are for a rocky year in U.S.-Japan trade relations.

Margo Grimm

Yen Had Good Year In 1991

Even though the Japanese economy decelerated rapidly and domestic financial markets became embroiled in scandal in 1991, at least one key economic indicator -- the yen -- turned in a strong performance. On an annual average basis the Japanese currency appreciated 7.6 percent against the dollar, reversing a two-year slide. Its average value for the year of Y134.6=$1.00 was the second highest on record, just behind the Y128.2 recorded in 1988 (see Table 1).

Table 1: **Yen-Dollar Exchange Rate, 1986-91**

(monthly average; Tokyo interbank market)

	1986	1987	1988	1989	1990	1991
January	Y200.0	Y154.5	Y127.6	Y127.2	Y145.1	Y133.9
February	184.6	153.5	129.2	127.8	145.5	130.5
March	178.8	151.5	127.3	130.4	153.1	137.2
April	175.6	143.0	125.0	132.1	158.5	137.1
May	166.9	140.5	124.8	138.4	153.5	138.1
June	167.8	144.5	127.1	143.8	153.8	139.8
July	158.7	150.2	133.1	140.7	149.3	138.0
August	154.1	147.6	133.6	141.1	147.4	136.9
September	154.8	143.0	134.4	145.1	139.0	134.6
October	156.0	143.5	129.0	141.9	129.7	130.7
November	162.7	135.3	123.2	143.5	129.1	129.7
December	162.1	128.4	123.6	143.6	133.7	128.1
Annual Average	168.5	144.6	128.2	138.0	144.8	134.6

In retrospect the yen's run-up actually began in 1990. After hitting a nadir on a monthly basis in April of that year, the Japanese currency trended higher, although March to June of 1991 ran counter to this pattern. The yen ended the year at Y124.8=$1.00, close to its all-time daily high of Y121.15 set November 24, 1988. Further strengthening in the early weeks of this year has brought the yen closer to that peak, with the Japanese currency closing January 6 at Y123.35, for example.

Against nondollar currencies the yen was similarly strong in 1991 (see Table 2). Fluctuations vis-a-vis Asian currencies were particularly interesting because they tended to debunk speculation in the U.S. media last year about the emergence of a bloc of Asian nations using the yen as a convenient means of settling international transactions. (For details of this concept in the context of internationalization of the yen, see *JEI Report* No. 38A, October 5, 1990.) Such an arrangement normally would imply that the currencies of the participating nations would fluctuate less against the yen than against the dollar. In fact, although some currencies, such as the Singapore dollar, were quite stable against the Japanese currency (which implies greater fluctuation against the dollar), most showed the opposite pattern. They moved against the yen in the same direction and in roughly the same magnitude as did the American dollar, repeating a pattern evident in 1990 as well (see *JEI Report* No. 2B, January 18, 1991). If anything, this result suggests that the currencies of South Korea, Hong Kong and Australia, for example, are more closely tied to the dollar than to the yen.

Table 2: **Changes in the Yen Against Selected Currencies, 1990-91**

(other currencies in terms of yen at yearend)

	1990	1991	Percent Change
German Deutsche mark	Y90.84	Y82.38	10.3%
British pound	262.09	233.31	12.3
Australian dollar	104.91	94.85	10.6
Canadian dollar	117.07	108.00	8.4
Korean won	0.19	0.17	10.3
Singapore dollar	78.25	77.01	1.6
Taiwan dollar	5.10	4.89	4.2
Hong Kong dollar	17.41	16.05	8.5
U.S. dollar	135.80	124.80	8.8

The yen's overall strengthening at a time when the Japanese economy was showing signs of weakness is not as surprising as it may seem. Compared to Washington, Tokyo was slow to ease monetary policy in 1991; accordingly, interest rates fell earlier in this country. In addition, Japan's relatively low rate of actual and probable inflation suggests that real rates were almost as high as nominal ones. As a result, Japanese securities attracted international investors, creating a demand for the yen and boosting its value. This relationship was exemplified by a sequence of events at yearend. After the Federal Reserve Board engineered a 1 percentage point cut in the discount rate December 20, the Bank of Japan trimmed half a point off its rate 10 days later (see *JEI Report* No. 1B, January 10, 1992). As expected, international currency markets responded by bidding up the value of the yen through at least the first week of 1992.

Predictions concerning the yen in 1992 vary tremendously, as usual. A *Wall Street Journal* survey of 42 American economists came up with a June 30 average value for the yen of Y128=$1.00 and a yearend value of Y132=$1.00, although a handful of respondents thought that the yen could be as weak as Y150 by yearend or as strong as Y120. A survey of 47 Japanese economists by the *Journal*'s Japanese counterpart, *Nihon Keizai Shimbun*, asked each expert to express the range over which the yen and the dollar would vary in 1992. Ten gave exactly the same answer: a high of Y120 and a low of Y140. The average high vis-a-vis the dollar, however, was Y117.55 and the average low Y140.59. Taking the midpoint of the average high and the average low as an estimated consensus forecast gives a prospective value of Y129.1 for 1992, remarkably close to the June and December forecasts of the American economists.

Currency values are notoriously difficult to forecast, in part because speculators push actual values close to credible predicted values very quickly. Hence, forecast values tend to become starting points during the forecast period rather than accurate estimates of trends. In 1991, however, the Japanese consensus forecast, calculated as described above, missed by a mere half yen the actual average value for the year of Y134.6=$1.00; the consensus American forecast was off by three-and-a-half yen. A problem with 1992 consensus forecasts, especially in the United States, is that they discount too strongly the possibility that the yen will establish a new high, breaking the Y120=$1.00 barrier. The strong momentum that began in 1990 may not yet have run its course, particularly since central bankers in both countries appear to have lost their aversion to a weak dollar. Nevertheless, inevitable fluctuations over the course of the year are likely to imply an average value of the Japanese currency in 1992 that is slightly stronger than Y130=$1.00.

Douglas Ostrom

Tokyo Stock Market Trapped In Bears' Hug

As if recovering from a very bad hangover, Japan's equity markets ended 1991 still working off the effects of the speculative investment binge of the late 1980s. According to data on the most recent trading, the "morning after" apparently will last well into 1992 as far as Japanese domestic stock market activity is concerned. While this bearish outlook may succor government policymakers worried about the return of speculative fever, those concerned about lagging domestic economic growth are less encouraged.

Compared to the record-smashing year of 1989, the past two years have been sharp disappointments. The Tokyo Stock Exchange's Nikkei average fell from a record high of 38,915.87 on December 29, 1989 to 20,221.86 on October 1, 1990 before recovering to 23,848.71 on December 28 that year (see *JEI Report* No. 8B, March 1, 1991). The TSE began 1991 in a hopeful mood, reacting calmly to the outbreak of actual combat in the Persian Gulf and joining other major bourses in a global rally when it became clear that the multinational effort to liberate Kuwait from Iraq would be brief and successful for the allies. With the conflict out of the way, according to Japanese bulls, the global economy would resume its forward march thanks, in part, to moderate and stable prices for crude oil. Unfortunately, the stimulative impact amounted to no more than a ripple. In Europe and the United States economies sagged under the weight of domestic and/or regional problems. Japanese bulls still expected the continued strength of personal consumption and capital investment to keep the domestic economy from being pulled down by foreign troubles. Their optimism proved unfounded.

Although the Nikkei Average hit 27,146.91 on March 18, the rest of the year would bring nothing but bad news for investors and brokers. Despite July 1 and November 14 cuts in the discount rate, the market plunged below 22,000 in August and managed only a modest rally in October (closing at 25,044.24 on November 1) before sliding down to 22,983.77 at the close of the year's last trading day, December 30. Just as important, daily average trading volume dropped for the third consecutive year. From the record of just over 1 billion shares a day in 1988, the average plunged to 483.9 million shares changing hands daily in 1990 and then to 372.9 million shares in 1991, the lowest level since 1982. Another indicator of market stagnation was the low ratio of total market turnover to the total number of shares outstanding. Last year's mark of 28 percent (for first section TSE stocks) represented the smallest figure since 1955 and was precipitously lower than 1988's 100 percent level.

The news is not all bad, according to Tokyo bulls. The inflow of foreign investment should continue to expand in 1992 -- it reached a record high of about $68 billion in 1991, according to a Japanese securities company -- since prices are at relatively low levels and price/earnings ratios more reasonable than in the last bull market. Moreover, the cuts in the discount rate since mid-1991 should begin to buoy business activity by the second half of 1992, analysts say; that outlook has generated hopes of higher corporate profits. Easier credit also could relieve anxieties about a potential real estate market crash since it would relieve pressure on firms with large real-estate loan burdens. Renewed growth in the United States and Europe also is expected to help the market's mood. With upper house elections coming in the middle of this year, some analysts predict that the ruling Liberal Democratic Party will advocate more fiscal stimulation, which would benefit domestic building materials and construction companies. The acuity of the bulls' crystal balls has been disproved in the past, however. Bearish investors seem to have a clearer vision of the market's immediate future.

Jon Choy

President's Asian Trade Offensive Leaves Japan's Automotive Makers On Defensive

Japan's automotive industry is in for rough political sledding in the United States this year. Detroit's multiple problems made that outcome all but inevitable before the chairmen of the Big Three U.S. motor vehicle companies met with their Japanese counterparts in Tokyo January 8-9; those unprecedented meetings sealed it. The heads of Chrysler Corp., Ford Motor Co. and General Motors Corp. went to Japan looking for a quick fix to the lopsided transpacific trade in automotive products. They knew, or should have known, that the Japanese side would not commit to specific cuts in the bilateral automotive trade deficit. Yet the Big Three executives returned home angry, with Ford chairman Harold Poling ready to join Chrysler's Lee Iacocca in backing mandated reductions in the U.S.-Japan trade imbalance over five years and Robert Stempel, head of GM, not ruling out his support.

The three American automotive heads did not leave Japan empty-handed, although that is the impression they gave. The five biggest Japanese motor vehicle manufacturers said they intended to buy $17.8 billion worth of U.S. parts in FY 1994 (see Table 1), nearly $9.3 billion above FY 1990's

Table 1: **Projected Purchases of U.S. Parts by Japan's Top Five Automotive Makers**

(in millions of dollars)

	Toyota	Nissan	Honda	Mazda	Mitsubishi	Total
FY 1990 (Actual)						
U.S. Operations	$1,900	$900	$2,520	$968	$527	$6,815
Japanese Operations	700	400	280	218	155	1,753
Total	2,600	1,300	2,800	1,186	682	8,568
FY 1994 (November 1991)						
U.S. Operations	3,600	2,780	4,150	1,890	1,130	13,550
Japanese Operations	1,000	520	350	270	270	2,410
Total	4,600	3,300	4,500	2,160	1,400	15,960
FY 1994 (January 1992)						
U.S. Operations	3,820	2,900	4,380	1,900	1,200	14,200
Japanese Operations	1,460	800	560	400	400	3,620
Total	5,280	3,700	4,940	2,300	1,600	17,820

Source: Company announcements

aggregate procurement level and $1.9 billion more than they had planned to source from American suppliers as part of the Ministry of International Trade and Industry's Business Global Partnership program (see *JEI Report* No. 44B, November 22, 1991). Most of the targeted purchases will be used by the U.S. production units operated by Toyota Motor Corp., Nissan Motor Co., Ltd., Honda Motor Co., Ltd., Mazda Motor Corp. and Mitsubishi Motors Corp. That will help insure that the domestic parts content of the vehicles made in the United States by the five reaches 70 percent by March 1995 compared with approximately 50 percent in FY 1990.

More important in the current political environment, the projected level of parts purchases for transplant cars and trucks could make a dent in the U.S.-Japan automotive trade deficit. Parts represented $9.9 billion of this country's $30.4 billion shortfall in automotive products in 1990, according to one of several methods of calculation, with the United States purchasing $10.6 billion worth of parts from Japan while sending only $764 million the other way. If the five automotive makers do boost domestic sourcing for their American factories to $14.2 billion in FY 1994, those purchases would displace up to $7.4 billion in parts that otherwise would be imported from Japan based on 1990 car and truck production levels and parts purchasing patterns. The additional $1.9 billion in parts the five Japanese companies plan to buy for use at home also will provide some bottom-line relief.

To make sure that "traditional" American parts producers win a big chunk of the extra business the five Japanese motor vehicle manufacturers promised to strengthen or expand existing efforts to help U.S. firms become part of their supplier ranks. For companies that already meet Japanese car and truck makers' quality, price and delivery requirements the key to gaining additional sales could be the pledge to promote the number of design-ins. (According to the government's "action plan," Japanese automotive makers had 332 ongoing design-ins with U.S. parts suppliers as of January 1991; another 271 had been completed.) For domestic parts firms still struggling to meet the demanding standards of Japan's motor vehicle industry the five biggest members said they would continue existing cooperative efforts (see *JEI Report* No. 30B, August 9, 1991).

Plans were vague for narrowing the huge gap between the value of cars and trucks Japan ships to the United States ($21.5 billion in 1990) and the flow the other way ($996 million the same year). Japanese automotive industry executives acknowledged as much before and after their meetings with the leaders of the Big Three, but they placed the blame squarely on GM, Ford and Chrysler. Japanese manufacturers and their dealers are prepared to supplement Detroit's own sales efforts in Japan, company spokesmen said, noting that dealerships now are free to handle more than one firm's vehicles and parts. There is a catch: U.S. competitors must bring the quality of their products up to the Japanese average and do more to tailor their exports to the Japanese market; otherwise, the cars just will sit on dealer lots.

Although Japan's five largest automotive producers did not want to be specific about their plans for handling American-made cars, the government prodded them into coming up with some numbers. Honda, which has been marketing part of Chrysler's Jeep line for the last year, said it was targeting Cherokee and Wrangler sales at 1,200 units in 1994, up from the 437 sold in 1991. Mitsubishi Motors also indicated it would help Chrysler raise sales in Japan by trying to sell 6,000 of the number-three U.S. automaker's cars in FY 1995. For its part Mazda, which makes Ford-badged cars at its Hiroshima complex for sale in Japan, plans to import 4,500 Ford Probes, Tauruses, Thunderbirds and Lincoln Continentals in the upcoming fiscal year, more than double the number for FY 1990; last year it sold 1,676 imported Fords. In addition, Nissan said it was willing to handle Ford vehicles for the first time; the second-largest Japanese car company has penciled in sales at 3,000 units a year. Finally, Toyota stated that it was prepared to sell about 5,000 GM products a year through its dealer network.

Big Three car sales in Japan, which totaled 13,711 vehicles in 1991, would more than double over the next three years if the Japanese industry's distribution plans are realized. But that still would be below the number of Mercedes-Benzs (34,187) or BMWs (33,798) sold last year. Moreover, Detroit's share of the Japanese car market would remain miniscule (see Table 2).

Table 2: **Car Registrations in Japan by Make, 1986-90***

(in units)

	1986	1987	1988	1989	1990
Japanese Makes					
Toyota	1,382,581	1,453,796	1,633,171	1,760,907	1,893,422
Nissan	765,738	764,633	860,680	996,988	1,056,920
Honda	304,946	337,094	401,070	457,559	514,709
Mazda	194,139	198,561	217,872	296,145	398,951
Mitsubishi	146,261	158,323	180,874	232,978	314,917
Daihatsu	87,609	75,767	90,139	157,046	254,975
Suzuki	63,626	62,148	64,546	140,201	247,675
Fuji	73,699	68,520	79,791	138,107	164,765
Isuzu	59,067	58,207	55,633	43,394	34,619
Japanese Makes	3,077,666	3,177,049	3,583,776	4,223,325	4,880,953
Imported Makes					
American Imports	2,345	4,006	14,511	19,084	28,602
General Motors	1,829	2,829	4,841	7,231	8,513
Ford	406	863	3,809	5,967	6,030
Chrysler	106	300	443	973	1,432
Honda	0	9	5,395	4,697	7,534
Diamond-Star	0	0	0	23	2,886
Toyota	0	0	0	146	2,109
Other American Imports	4	5	23	47	98
German Imports	53,916	74,289	91,648	120,293	137,442
Mercedes-Benz	13,820	18,749	22,625	31,511	38,844
Volkswagen	16,067	23,740	27,947	34,674	36,770
BMW	15,250	21,015	26,826	33,076	36,527
Audi	7,717	8,772	11,342	14,306	16,691
Other German Imports	1,062	2,013	2,908	6,726	8,610
British Imports	4,033	6,771	9,789	14,519	19,653
Rover Group	2,880	5,166	7,371	10,655	14,431
Other British Imports	1,153	1,605	2,418	3,864	5,222
Swedish Imports	3,151	4,699	6,737	9,753	13,704
Volvo	2,228	3,265	4,634	7,122	10,915
Other Swedish Imports	923	1,434	2,103	2,631	2,789
French Imports	1,729	3,933	6,153	10,487	14,018
Italian Imports	3,046	3,832	4,216	4,564	5,933
Other Imports	137	221	529	1,724	2,354
Imported Makes	68,357	97,751	133,583	180,424	221,706
Total Registrations	3,146,023	3,274,800	3,717,359	4,403,749	5,102,659

*Includes minicars, defined as cars with an engine displacement of 550 cubic centimeters or less.

Source: Japan Automobile Manufacturers Association, *Motor Vehicle Statistics of Japan 1991.*

Automotive-state legislators on Capitol Hill were just as dismissive of the Japanese industry's parts purchasing and car sales plans as the Big Three executives had been. House Majority Leader Richard Gephardt (D, Mo.) was quoted as saying, "I didn't expect much and we didn't get much. Promises are no substitute for action, and in this case even the promises aren't worth much." He added: "The only way to get action is to continuously put pressure on the Japanese."

Rep. Gephardt already had prepared the means -- the Trade Enhancement Act, a variant of the measure he had pushed through the House when the 1988 trade act was being crafted. Unveiled December 20 and expected to be introduced in late January, the bill would require Japan to cut the 1991 bilateral trade deficit of roughly $42 billion by 20 percent a year for the next five years. If it came up short, the White House would cap the sale of domestically made and imported Japanese cars and trucks in 1992 at what Mr. Gephardt calculated was last year's level of 3.8 million units. The ceiling would apply to any vehicle with less than 60 percent of the value of its parts sourced from "traditional" American suppliers, and it would be lowered by 250,000 units each year that Japan failed to meet its deficit-reduction target.

The Gephardt initiative also would force the executive branch to do what the Department of Commerce's Auto Parts Advisory Committee has failed to achieve: self-initiate a dumping proceeding on Japanese-made automotive parts as well as an unfair trade practices investigation under Section 301 of the 1974 Trade Act of "Tokyo's toleration of systematic anti-competitive practices" in automotive parts (see *JEI Report* No. 30B, August 9, 1991). Under another provision the bill would direct the president to persuade Tokyo to extend its current quota on U.S.-bound car shipments to transplant production containing less than 60 percent "true" U.S. content; that is a longtime Chrysler and United Auto Workers union demand.

Despite broad support for the Trade Enhancement Act among House and Senate Democrats, passage of the bill in anything close to its original shape was questionable when the chairmen of the Big Three flew off to Tokyo to join other members of the business delegation accompanying President Bush. The odds of enactment improved when Messrs. Iacocca, Poling and Stempel returned home.

Susan MacKnight

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JAPANESE AND U.S. PRODUCTIVITY AND ECONOMIC GROWTH

SUMMARY

Japan has enjoyed high rates of productivity growth by virtually every measure since World War II and especially in the period between the end of the war and the first oil shock in 1973. During this nearly 30-year span, marked by strong productivity performances in many nations, Japan was the outstanding performer. This feat had parallels to the achievements made by America in the 60 years preceding World War II when the United States was a leader in productivity gains.

Economists have found strong evidence for the "catch-up" hypothesis of productivity gains, at least among the group of developed nations. Such a hypothesis appears to have been a factor in prewar U.S. productivity growth as well as postwar Japanese productivity improvements. Strong rates of capital accumulation, too, were evident in America in the prewar era and in Japan in the postwar period. And, since technological change is tied closely to capital growth, technology appears to have been a factor in boosting the American and the Japanese economies in the prewar and postwar periods, respectively.

These arguments suggest that the relatively rapid growth in Japanese productivity in the recent past was partly a historical anomaly. Even though Japan's ongoing high rate of business investment indicates that productivity growth components still are present, capital spending has become less potent yen for yen in generating economic expansion in recent years. As the Japanese population ages — and capital substitutes for labor — capital growth alone may be insufficient by the end of the decade to keep the Japanese economy advancing at recent rates.

Japan's Recent Economic Performance

In the years since at least the Korean War Japan has enjoyed high rates of economic growth relative to other industrialized nations. One way of comparing growth rates among nations is to look at relative rates of advancement in labor productivity, essentially the rate of increased output per worker.[1] According to Bureau of Labor Statistics data, labor productivity in manufacturing grew an average 7.5 percent per year between 1950 and 1990 in Japan, nearly three times as fast as the 2.7 percent average gain registered for that period in the United States.[2] Even if the extraordinary productivity advances that resulted from reconstruction following World War II are ignored by using 1960-90 figures, annual Japanese productivity growth for the period amounted to 6.9 percent against 2.9 percent for the United States.

Japan's rapid productivity increases have elevated its status to that of an economic superpower second only to the United States. To some Americans this development points to an unpleasant, not-so-distant future in which Japan's economy will be the world's largest — just as earlier American growth enabled this country to surge past other nations economically. In general, public policy discussions of the issue in the United States have two dimensions. First, analysts urge Americans to rediscover the traits that "made this country great" and the most productive nation in the world. Second, many experts urge the United States to look across the Pacific in hopes of discovering the Japanese secret of rapid economic growth. However, economic research suggests that both these approaches, while not without merit, contain numerous blind alleys. To understand why, one has to understand the path each nation took to its current position.

The Long Sweep of History: The United States

Few Americans question that the United States ended World War II as the world's preeminent economic power. But how did that happen? The average American probably has little understanding of how the United States went from an obvious position of economic inferiority as a British colony at the time of the Revolutionary War to its economic superpower status 175 years or so later. If pressed, many Americans probably would attribute a major role to "Yankee ingenuity." Certainly, many famous U.S. inventors, such as Thomas Edison, were active around the turn of the century as America surpassed in economic terms the leading power of the time, Great Britain. But linking the U.S. spurt to inventions seems an inadequate explanation. Inventions easily could be copied in a few short years by other countries, thereby conveying little permanent economic advantage to the United States.

Economists and historians have much more complex explanations. A recent article by Gavin Wright, an economic historian at Stanford University, is particularly eye-opening. He claims that abundant natural resources in the United States played an important role in America's rise to economic preeminence. Especially in the first four decades of this century, Mr. Wright argues, the United States was able to tap oil, iron ore and other natural resources to build a mighty industrial machine. He implies that such natural endowments extended a critical advantage to this country over

[1] Total factor productivity, an alternative gauge, adjusts for the expansion in the amount of capital with which each worker works and may take other factors into account as well; for this reason TFP growth is likely to be far smaller than the gains in labor productivity. For additional details concerning both concepts, see *JEI Report* No. 36A, September 22, 1989.

[2] Department of Labor, Bureau of Labor Statistics, "Output per Hour, Hourly Compensation, and Unit Labor Costs in Manufacturing, Twelve Industrial Countries, 1950-1990," (unpublished data) December, 1991, p. 1.

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the nations of Europe, for example.[3] (While other nations and territories in the Middle East and elsewhere were better endowed, their resources either were undiscovered in the early decades of this century or the areas lacked the means to link resources to industrial development.)

In Mr. Wright's view a highly educated labor force, abundant capital stock and a strong infrastructure were more effects than causes of America's relative industrial advantage. However, once the U.S. labor force did become relatively well-educated, for example, the United States could maintain its economic lead for years even after resource abundance ceased to be a major contributor. (America's resources stopped being an important advantage once improved international transportation and other factors enabled nations to exploit worldwide natural resources more easily.)

Certainly the data on this country's rise in productivity and economic status are impressive. From being 9.9 percent poorer on a per-capita basis than Great Britain in 1870, the United States was 5 percent wealthier by 1890 and 46 percent wealthier by 1929. During the 59 years between 1870 and 1929 real gross domestic product per worker increased 3.5 times, or 2.1 percent a year. By 1913, if not earlier, real gross domestic product per person was almost 14 percent higher than in any of five other industrialized nations (France, West Germany, the Netherlands, Great Britain and Japan) included in one well-known study; by 1950 the gap had widened further.[4]

Mr. Wright's view of American economic history has important implications for current economic policy. First, it does not mean that Americans are doomed unless they discover more domestic oil, for example. Natural resources no longer matter as much as they did in the early decades of the 20th century; in hindsight that period appears to have been unique in that respect. What is more important is that the elevation of natural resources as an explanatory factor during this critical period of American economic history implies a lesser role for education, innovation and cleverness, which some Americans probably have assumed were the explanations. In short, if Mr. Wright is correct, Americans got where they did partly by the good fortune of living in a geographically blessed place, not by being smart or particularly industrious. If hard work, education and training are critical to the future, Americans may not have an inherent advantage over other nations in this regard.

Not all scholars put equal emphasis on the explanatory power of natural resources, of course. Edward N. Wolff of New York University gives attention mainly to the growth of the capital stock as well as the interaction between an accumulating stock of plant and equipment and other dimensions of economic growth, such as total factor productivity growth, a measure that normally is assumed to be independent of the size of the capital stock and the labor force. He notes that Great Britain achieved the highest intensity of capital use in 1870 and 1880, years it also held top ranking as an economic power. By 1938 the United States had both the most capital-intensive economy and the wealthiest one, having experienced exceptionally high rates of growth in both capital and per capita income in the half-century since 1880. This relationship between capital stock and economic well-being also held true for nations in intermediate positions of capital growth and economic expansion.[5]

[3] Gavin Wright, "The Origins of American Industrial Success, 1879-1940," *The American Economic Review*, LXXX, September 1990, pp. 651-668.

[4] Angus Maddison, "Growth and Slowdown in Advanced Capitalist Economies: Techniques of Quantitative Assessment," *The Journal of Economic Literature*, XXV, June 1987, pp. 649-698.

[5] Edward N. Wolff, "Capital Formation and Productivity Convergence Over the Long Term," *The American Economic Review*, LXXXI, June 1991, pp. 565 579.

The Long Sweep of History: Japan

Japan's rise to second place among economic powerhouses is no less dramatic than the earlier process in the United States. Using the same benchmarks as above, Japan was only 17.4 percent as productive as Great Britain in 1870 — 17 years after Commodore Matthew Perry was credited with beginning the process of opening Japan to the West and a mere two years after the Meiji Restoration began transforming Japan, a benchmark often considered the beginning of the country's industrialization process. In the last three decades of the 19th century and the first half of this century, however, Japan's economy grew only slightly faster than the economies of leading industrial countries despite the fact that Japan could tap two centuries of Western technological advances for the first time. By 1929 Japanese hourly per-worker productivity still was only 31.4 percent that of British workers. The United States and other industrial countries lost little ground to Japan; Japanese hourly per-worker output improved only from 19.3 percent of the comparable American figure in 1870 to 21.5 percent in 1929.[6]

Japan's rise to the number-two spot really started after reconstruction began to alleviate the massive destruction from World War II. In 1950 U.S. gross domestic product per hour worked was 7.2 times as large as that of Japan's. By 1984 the gap had narrowed to 1.8, and by the end of 1991 it had shrunk to an estimated 1.5, suggesting that American workers are roughly 50 percent more productive than their Japanese counterparts once the differing sizes of the two labor forces and the number of hours worked on the job are taken into consideration. (This measure does not make any adjustment for the size or the quality of the capital stock available to workers.)

A disproportionate amount of the U.S. advantage is a result of low productivity in the Japanese agricultural sector. Several studies, including some that exclude agriculture or adjust for capital stock, conclude that the U.S.-Japan productivity gap is far smaller than 1.5:1, although the authors of these studies all agree that the United States still has an overall advantage, if not in every industrial sector.

Based on a transpacific productivity ratio of 1.5:1 in 1991 and assuming a continuation of the rates of change observed since 1984, Japanese GDP per hour worked will surpass the comparable figure for the United States in the year 2011. However, as will be argued below, extrapolation of past trends probably overstates the speed with which Japan will achieve productive equality with the United States. In addition, with this country's far larger labor force, the absolute size of the American gross domestic product still will be much bigger in 2011 — a conclusion made even more likely because the Japanese labor force is expected to begin to shrink by the end of this decade (see *JEI Report* No. 46A, December 7, 1990).

Explaining Japan's Rise to the Number-Two Position: 1950 to 1973

Although the figures just cited suggest that Japan's rate of economic growth is not likely to prevent the United States from being the most economically productive nation for the entire 20th century, the Asian nation's accomplishments are impressive, particularly since World War II. What changed after World War II? For many economists the answer is a phenomenon sometimes called "trend acceleration."[7]

Briefly, a number of factors came together after World War II to propel Japan to the front ranks. The single most important element was an increased rate of capital accumulation. Domestic firms used the surplus savings of Japanese households, as well as their own earnings, to invest in new plant and equipment at an unprecedented rate. Figures cited by Angus Maddison in an assessment of six industrialized nations show, for example, that Japan's nonresidential gross capital stock adjusted for inflation increased 7.2 times between 1950 and 1973, more than twice as fast as any of the other five nations (France, West Germany, the Netherlands, Great Britain and the United States) that he surveyed. The growth in the quantity and the quality of the nonresidential capital stock, in turn, explained 1.4 percentage points of the 7.1 percentage point **acceleration** in the expansion of Japan's real GDP in the 1950-73 period compared to the 1913-50 time frame. (For details of investment and savings in Japan, see *JEI Report* No. 37A, October 4, 1991.) In addition, the labor force grew more rapidly after the war, adding 0.6 point to the acceleration of GDP growth. Other labor and capital variables added 1.8 points to the acceleration of growth for a total of 3.8 points, or 53.5 percent of the faster pace of economic expansion.[8]

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[6] Calculated from data in Maddison, *op. cit.*, p. 683.

[7] A path-breaking analysis of the Japanese case is provided by Kazushi Ohkawa and Henry Rosovsky, *Japanese Economic Growth: Trend Acceleration in the Twentieth Century* (Stanford, California: Stanford University Press, 1973).

These factors were not the only significant ones. Mr. Maddison identified eight more factors that were important in addition to the six capital and labor variables. The first column of Table 1 indicates the contribution to GDP growth of all 14 factors in the 37 years through 1950, with the second and the third columns of data showing their relative contributions at different stages of Japan's postwar experience.

Table 1: **Sources of GDP Growth in Japan, 1913-84**

(contribution to GDP growth)

	1913-50	1950-73	1973-84
Labor Quantity	0.4%	1.1%	0.4%
Labor Quality	0.6	0.5	0.4
Labor Hoarding	-0.6	0.9	-0.2
Housing Stock	0.0+	0.4	0.5
Plant and Equipment Quantity	0.8	2.1	1.7
Capital Quality	0.5	0.6	0.4
Capacity Use Effect	-0.2	0.4	0.0
Catch-up Effect	0.0	1.0	0.4
Structural Effect	0.6	1.2	0.2
Foreign Trade Effect	0.0+	0.3	0.1
Economies of Scale	0.1	0.3	0.1
Energy Effect	0.0	0.0	-0.1
Natural Resource Effect	0.0	0.0	0.0
Regulation and Crime	0.0	-0.0	-0.1
Total	2.1	8.8	3.7
Gross Domestic Product	2.2	9.4	3.8
Percentage Explained	94.0	93.0	99.0

Note: For descriptions of each category, see source listed below.

Source: Angus Maddison, "Growth and Slowdown in Advanced Capitalist Economies: Techniques of Quantitative Assessment," *Journal of Economic Literature,* XXV, June 1987, p. 679.

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[8] Maddison, *op. cit.*, pp. 691, 680.

Two factors stand out in addition to those involving capital and labor. The first is structural change, which refers to the shift in the relative importance of different industries in Japan. As demand grows in productive sectors relative to those with lower productivity, the overall efficiency of an economy increases. This was a particularly important factor for Japan in both the prewar and the postwar period as manufacturing grew relative to agriculture. By contrast, in some other countries, including the United States, the structural effect was a negative factor in the postwar period because arguably unproductive service industries grew vis-a-vis manufacturing.

The second factor that stands out is the catch-up effect. This measure refers to the fact that a country less advanced technologically should be able to grow more rapidly as it copies state-of-the art technologies from the leader (identified throughout Mr. Maddison's sample as the United States). Mr. Maddison's data suggest that this factor was completely absent in Japan's prewar years, a striking result since the Meiji Restoration had occurred 45 years prior to the beginning of the examined period. Some experts have explained this apparent result as a consequence of Japan's backward movement relative to other industrial countries during the militarization of the Japanese economy in the 1930s plus the intensified war effort and the country's isolation from 1941 to 1945. In the early postwar period, however, the catch-up effect accounted for 1 point or 10.6 percent of overall growth, according to Mr. Maddison's analysis.

The Slowdown: 1973 to 1984

Many of the elements contributing to Japan's economic growth reversed themselves in the most recent period surveyed by Mr. Maddison. The slower pace of Japan's economic expansion since 1973, a subject of intense interest to economists, raises the question as to whether the early postwar period was a sort of "Golden Age" for economic growth that is not likely to be repeated soon. If so, the data suggest that the period was particularly gilded in Japan since growth accelerated the most from the prewar period and then decelerated the most after 1973.

The choice of 1973 as the dividing line is not arbitrary. That year marked the beginning of what now is known as the first oil shock. Oil prices rose rapidly in 1973 and 1974 and again in 1979 and 1980, the time of the second oil shock. (For a discussion of this period and an analysis of the macroeconomic effects of oil imports on the Japanese economy, see *JEI Report* No. 33A, August 24, 1990.) Although some economists contend that the shocks hit Japan particularly hard because of its dependence on imported oil, thereby creating an adverse terms of trade effect, Dale Jorgenson of Harvard University suggests that another effect also was important. He argues that during the postwar period until 1973 Japan experienced what he calls "energy-using technical change." By this he means that, absent changes in the prices of inputs, over time technological change will lead to greater use of energy and less consumption of other inputs for a given level of production. He finds, therefore, that the rate of technological change declined after 1973 because the price of energy rose, and Japan (like the United States) was forced to use less energy-intensive (more energy-efficient) forms of production that were less advanced technologically.[9] Even though the production methods used after 1973 may well have incorporated different or even new technology, they were not as productive as those used previously, according to Mr. Jorgenson.

Mr. Jorgenson's results, shown in Table 2, like those of Mr. Maddison reported in Table 1, suggest that the rate at which Japan was able to grow as a result of improving technology slowed markedly after 1973, although the two authors have differing explanations. Mr. Jorgenson attributes the slowdown to higher energy prices, while Mr. Maddison implies that Japan largely had caught up with technology elsewhere.

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[9] Dale W. Jorgenson, "Technological Innovation and Productivity Change in Japan and the United States," *The American Economic Review: Papers and Proceedings*, LXXVIII, May 1988, pp. 217-222, especially p. 220.

Table 2: **Alternative Measure of Sources of Economic Growth in Japan**

(contribution to growth of output)

	1960-79	1973-79
Labor Quantity	0.5%	0.4%
Labor Quality	1.0	0.5
Capital Quantity	3.2	2.4
Capital Quality	1.8	0.5
Weighted Average Technical Change	0.7	-1.2
Structural Effect	1.4	1.4
Net Output	8.3	3.8
Percentage Explained	103.6	105.3

Calculated from data in Dale W. Jorgenson, "Technological Innovation and Productivity Change in Japan and the United States," *The American Economic Review: Papers and Proceedings*, LXXVIII, May 1988, p. 218.

Japan's Productivity Growth in Historical Perspective: A Summation

While Messrs. Jorgenson and Maddison measure technology or productivity as a separate factor from capital accumulation, other experts are not so sure. Edward N. Wolff, who studied the period from 1870 to 1979, found that nations with higher rates of capital accumulation also have higher rates of total factor productivity growth.[10] Hence, technology and capital growth are not really independent; new technology tends to get incorporated most easily in new plant and equipment. This finding meshes with Mr. Wolff's result (cited earlier) that fast-expanding nations, such as the United States in the prewar period or Japan in the postwar era, simultaneously have had high rates of total factor productivity growth and capital accumulation; together, these two factors practically guarantee rapid real growth per capita.

Some of Mr. Wolff's other findings have special relevance for Japan. That country's high rate of total factor productivity growth, which Mr. Maddison and others have suggested picked up speed in the three decades after World War II, was part of a pattern, according to Mr. Wolff; on average he found that TFP grew more rapidly worldwide between 1950 and 1979 than from 1870 to 1938 (see Table 3). In addition, he found that total factor productivity tends to grow fastest the further behind a nation is vis-a-vis the technological leader. This result, which confirms earlier findings derived from various methodologies by a number of researchers, is an alternative to Mr. Jorgenson's explanation for the low rates of technological change in Japan after the first oil shock. Most intriguing of all Mr. Wolff's findings concerning Japan is that, once he controls for all other factors, the "country effect" (the fact that Japan is Japan and not some other country) is negative. In other words, Japan enjoyed rapid economic growth during the 109-year period that Mr. Wolff studies, but the unquantifiable conditions unique to Japan ***retarded*** that process. He does not speculate what those factors might have been.[11]

[10] Wolff, *op. cit.*, pp. 572-574.

[11] Wolff, *op. cit.*, p. 574.

Table 3: **Various Measures of Total Factor Productivity Growth in Five Industrialized Countries, 1870-1990**

(average annual rate of change)

	Wolff		Maddison			OECD		
	1870-1938	1950-79	1913-50	1950-73	1973-84	1960-73	1973-79	1979-90
United States	0.77%	1.36%	1.99%	1.85%	0.52%	1.6%	-0.4%	0.3%
Japan	1.32	4.17	1.10	5.79	1.21	5.9	1.4	2.0
West Germany	1.20	3.33	0.86	4.32	1.55	2.7	1.8	0.8
United Kingdom	0.75	1.48	1.15	2.14	1.22	2.3	0.6	1.6
France	n.a.	3.04	1.42	4.02	1.84	4.0	1.7	1.7

Sources: Edward N. Wolff, "Capital Formation and Productivity Convergence Over the Long Term," *The American Economic Review*, LXXXI, June 1991, p. 568.

Angus Maddison, "Growth and Slowdown in Advanced Capitalist Economies: Techniques of Quantitative Assessment," *The Journal of Economic Literature*, XXV, June 1987, p. 665.

Organization for Economic Cooperation and Development, *OECD Economic Outlook*, No. 50, December 1991, p. 136. (Figures refer to total factor productivity growth in the business sector calculated by taking a weighted average of growth in labor and capital productivity.)

Productivity Growth Since 1984

The academic research summarized above, while beginning with the process of modern Japanese economic growth in the 19th century, seldom brings the story beyond the mid-1980s. What has happened since? Net nominal business investment as a share of nominal gross national product rose from 15.3 percent to 19.6 percent between 1984 and 1990, the latest year for which data are available. Similarly, real business investment increased over the same period from 15.1 percent to 21.5 percent of inflation-adjusted GNP. As a result, the growth of the stock of real business capital — which grew as fast as 16 percent in 1970 and then declined annually before bottoming out at around 6 percent in 1983 — rebounded to an approximate 8 percent rate in 1990. Real GNP growth similarly sprang back; after averaging 3.8 percent annually between 1980 and 1985, it increased 4.7 percent a year between 1985 and 1990.

As a result of the increase in plant and equipment, each unit of labor had more capital to work with in the second half of the 1980s than previously, leading to a rise in labor productivity; that implies that the growth of labor productivity remained positive in the 1985-90 period. The Organization for Economic Cooperation and Development estimates that the rise in labor productivity in the business sector increased from 2.9 percent average annual growth between 1973 and 1979 to 3 percent a year between 1979 and 1990. Total factor productivity expanded by a larger margin, going from a 1.4 percent rate of yearly growth in the 1973-79 period to a 2 percent annual pace in the 1979-90 time span (Table 3). Among most European member nations of OECD total factor productivity grew more slowly in the 1979-90 period than in the years between 1973 and 1979, although still at a faster pace than in the United States. Here, total factor productivity turned in a positive performance from 1979 to 1990 after declining in the 1973-79 time span.

However, labor productivity in the critical manufacturing sector alone has exhibited somewhat different trends, particularly in recent years. According to the Bureau of Labor Statistics, average annual manufacturing labor productivity between 1979 and 1990 rose 4.1 percent in Japan and 3.1 percent in the United States but 4.4 percent in the United Kingdom. Of the 12 nations (the United States, Canada, Japan, Belgium, Denmark, France, West Germany, Italy, the Netherlands, Norway, Sweden and the United Kingdom) in the BLS survey, Japan could manage only third place in labor productivity in manufacturing over the period 1979-90; the United States ranked sixth.[12]

Another way of approaching the question of productivity is to look at the trend in a country's capital-to-output ratio. As the Japanese economy grew, the amount of plant and equipment needed to produce a given unit of output increased from less than 0.8 unit of capital per unit of GNP in 1966 to 1.4 units in 1984 and nearly 1.6 units in 1990.[13] Another way of making the same point is to say that each additional unit of capital added less to output than the one before. (In economists' jargon this statement implies that both the marginal physical product and the average physical product of capital declined from previous levels but still were positive.) This argument suggests that larger and larger increments of capital will be necessary to maintain a given rate of economic growth.

Implications for Japan and the United States

Virtually all the factors considered above suggest that Japan will find it next to impossible to regain the economic growth rates that it enjoyed from the 1950s until the time of the first oil shock. Energy prices, which have fallen in real terms in recent years, have less of an effect than the maturation of the Japanese economy. Catch-up by means of borrowing technology from abroad is

[12] Department of Labor, Bureau of Labor Statistics, *op. cit.*

[13] Robert Alan Feldman, "Japanese Business Investment: Too High, Too Low, or Just Right?" *Japanese Economic Research* (Salomon Brothers), August 5, 1991, p. 6.

mostly complete. Similarly, most of Japan's structural shift out of agriculture into manufacturing has been accomplished. Investment will have to grow even beyond its existing high level just to maintain current growth rates over the longer term. In fact, as Japan's labor force ages and begins shrinking toward the end of this decade, the substitution of capital for labor could accelerate, pushing the country's capital-output ratio down further.[14]

On balance, most of the studies summarized above imply a relatively favorable outlook for future economic growth in the United States vis-a-vis that in Japan. Japan has tended to look good relative to the United States, especially in the postwar period, because the two countries for nearly 100 years were at opposite ends of the economic development continuum among industrial or industrializing nations. That period is ending, however.

Contrary to widespread popular belief in both countries, Japan has not achieved productive parity with the United States. As noted earlier in discussing the Maddison study, the gap had narrowed significantly but not disappeared by 1984; estimates for 1990 based on his techniques show that a large gap remains. Mr. Jorgenson and coauthor Masahiro Kuroda of Keio University demonstrate in a recent study that, although several Japanese industries are more productive than their American counterparts, on balance the reverse is true; overall Japanese productivity in 1985 was equal to 87.1 percent of American productivity in the industries studied after adjusting for differences in the amount of capital used. In 13 of 28 industries, the authors observe, the United States enjoyed growing productivity advantages or shrinking productivity disadvantages between 1980 and 1985; on balance relative productivity changed little between these years.[15] (Their analysis requires the use of data that is available only after a considerable lag.)

Messrs. Jorgenson and Kuroda also conclude that the industry-by-industry variance in productivity differences between the United States and Japan is widening. Comparative advantage, considered by economists to be the reason nations trade with each other, is based on differences in relative productivity among countries. As a result, increasing variation across industries creates new opportunities for trade; even if one nation has some advantages in supplying its own market, firms from the other nation are likely to be successful in overcoming those strengths as a result of superior productivity. Trade friction can be expected to rise in conjunction with the number of industries perceiving themselves as under foreign siege.[16]

Messrs. Jorgenson and Kuroda argue, however, that the roots of the trade imbalance between the United States and Japan do not lie with productivity differences. Their argument is consistent with economic theory, which suggests that even if the United States had an absolute productivity

[14] However, between 1992 and 1995 Japan will be able to maintain high rates of growth without significant increases in capital spending because relatively large increases in the capital stock already are in the pipeline. For details, see *Ibid.*, p. 10.

[15] Dale W. Jorgenson and Masahiro Kuroda, "Productivity and International Competitiveness in Japan and the United States, 1960-1985" in C.R. Hulten (ed.), *Productivity in the U.S. and Japan* (Chicago, Illinois: University of Chicago Press, 1990); reprinted with revisions in B. Hickman (ed.), *Productivity and International Competitiveness* (Oxford, England: Oxford University Press, forthcoming).

[16] Rising trade friction often is reflected in an increasing number of complaints concerning "fairness" in international trade. For an econometric effort to find evidence for a relationship between the number of fairness complaints in the media and sectoral trade imbalances, see Roger Benjamin, Loren Yager, Michael Shires and Mark Peterson, *The Fairness Debate in U.S.-Japan Economic Relations* (Santa Monica, California: Rand Center for U.S.-Japan Relations, 1991), pp. 18-24. They find weak evidence of a relationship in manufacturing as a whole but not in the areas of high technology manufacturing or agriculture.

disadvantage in every industry trade still would be worthwhile; the United States simply would export those goods in which its productivity disadvantage was the smallest. Whether exports would exceed imports or vice versa is linked not to this country's absolute or relative productivity vis-a-vis its trading partners but rather to macroeconomic factors.

In any case, as noted above, the United States still has a productivity edge on Japan; in some industries this edge has grown even as the bilateral trade picture with Japan deteriorated from the U.S. perspective. Messrs. Jorgenson and Kuroda suggest that the real causes of the U.S.-Japan trade imbalance lie in currency movements, especially the strong dollar of the early 1980s, and in relative rates of wage and price increases, which were greater in the United States than Japan at that time. As a result, the authors imply that extraordinary efforts — such as industrial policy to boost U.S. competitiveness -- are misguided. (For a description of Japanese industrial policy and comparisons with proposed U.S. policies, see *JEI Report* No. 29A, August 2, 1991.)

Conclusion

Japan has had an impressive record of economic growth over the past century, but for the first half of that period the United States had an equally impressive performance. Similarly, Japan's days in the spotlight as the country with the fastest-growing economy among mature industrial nations appear to be numbered.

To whatever degree some American policymakers may wish otherwise, Japan's achievements will not go away. On the contrary, the ways in which Japan and the United States interact economically are likely to increase unless trade restrictions rise significantly. Should tensions lead to such a change in the relationship, both countries, which have benefited until now from relatively open trading systems, would be the losers.

For further information, contact **Douglas Ostrom**.

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Senate Panel Reviews President Bush's Trip To Japan

Even before President Bush had returned from Japan, the results of his January 7-10 visit were being analyzed and debated by politicians of all stripes. In Congress several critics of the White House's trade policies were quick to conclude that the trip had made little progress toward resolving this country's trade problems with Japan. Debate over what the Bush administration entourage had achieved in Tokyo grew more heated after Prime Minister Kiichi Miyazawa said January 20 that the Japanese automotive industry's plan to distribute roughly 20,000 American-made cars a year at home and to buy more parts was "a target rather than a firm promise." The prime minister's comments hardened the resolve of some legislators to pin down the executive branch on what was accomplished in Japan.

Soon after the president concluded his trip Sen. Lloyd Bentsen (D, Texas) announced that the Committee on Finance, which he chairs, would review the results of the mission. At the resulting Finance Committee hearing January 23 Sen. Bentsen said he called the meeting to ask the administration how many of the jobs being attributed to the U.S.-Japan trade deficit the trip would recover. Saying he was skeptical about whether the high expectations for the visit would be matched by results and implying that the Bush administration continuously took a weak stand toward Tokyo, Sen. Bentsen pointedly asked: "Is Japan backsliding on firm commitments or were commitments never firm?"

Many of Sen. Bentsen's Finance Committee colleagues expressed similar disappointment with the January visit. Several Democrats questioned its premise. Sen. Max Baucus (D, Mont.) said the trip "smacks of a political quick fix;" Sen. John Rockefeller (D, W.Va.), too, characterized it as politically motivated. Some Republicans on the committee also had criticisms. Sen. Dave Durenberger (R, Minn.) reported that his constituents viewed the inclusion of the chairmen of the Big Three motor vehicle companies on the trip as a big mistake. Sen. John Chafee (R, R.I.) called the auto executives' appearance a "fiasco." Several senators argued that solutions to U.S. competitiveness problems need to be sought at home. Sen. Bentsen noted that the United States "desperately need[s] a national economic strategy," while Sen. Durenberger said Minnesotans told him they want "long-range thinking" about this country's economic difficulties.

Lawmakers from both parties noted, however, that the president's trip to Asia highlighted the importance of trade as a policy issue. Sen. Bentsen said that the tour underscored for Americans that international trade has a direct impact on jobs in this country. Republican Sens. William Roth (Del.), John Danforth (Mo.) and Orrin Hatch (Utah) lauded what they perceived as the visit's message that trade is a key concern of the Bush administration. The Asia trip was "exactly what [members of the committee] have been asking the president to do for at least 15 years," Sen. Danforth said. It was, he said, "not a trip for detailed negotiations" but to emphasize that trade is a priority.

U.S. Trade Representative Carla Hills responded to the panel members' comments by defending not only the accomplishments of the president's Tokyo meetings but the White House's Japan trade policies. Ms. Hills outlined the administration's three-part plan of action to open Japanese markets for U.S. exports and investment: eliminating barriers in specific sectors, lowering economywide barriers through the Structural Impediments Initiative talks, and negotiating additional or stronger multilateral trade rules, lower tariffs and greater market access in the Uruguay Round. Pointing to the decline in the U.S. trade deficit with Japan since 1988, Ms. Hills asserted that this policy is paying off but acknowledged that "there is still much work to be done."

President Bush "accomplished much during his visit" to Japan, USTR Hills said, citing the new rules on public-sector procurement of computer hardware, software and services plus steps to improve the access of foreign suppliers to Japan's paper and glass markets as well as to address the bilateral imbalance in the automotive industry (see *JEI Report* No. 2B, January 17, 1992 and No. 3B, January 24, 1992). Ms. Hills also outlined the trade agreements reached with Japan throughout Mr. Bush's tenure, noting, "The only sure way to open Japan's markets is with steady, persistent pressure."

Several members of the Finance Committee, however, pushed the top U.S. trade negotiator on what they perceive as persistent problems in U.S.-Japan trade relations. Asked by Sen. Bentsen if the commitments reached in Tokyo were "targets or firm," Ms. Hills said the public-sector computer procurement pact was a government-to-government agreement that will be monitored and enforced. The section of Japan's "action plan" dealing with cars represented a private-sector commitment, while the pledge to boost purchases of U.S.-made automotive parts was a target that "will be watched," Ms. Hills said.

Sens. Baucus and Danforth, who last October jointly introduced a bill to extend the Super 301 provision of the 1988 trade act through 1997, both queried Ms. Hills on the administration's opposition to renewing the measure, which covered 1989 and 1990 only. The Super 301 provision required the executive branch to identify priority countries for market-access talks and authorized the White House to retaliate if negotiations with targeted countries did not result in agreements to eliminate the cited trade barriers. USTR Hills, saying that she was "not enthusiastic about that trade tool," reiterated executive branch arguments that the deadlines imposed by the Super 301 provision complicate negotiations.

Sen. Donald Riegle (D, Mich.) questioned Ms. Hills on another legislative proposal intended to reduce the U.S. trade shortfall with Japan. The Trade Enhancement Act of 1992, introduced January 22 by Sen. Riegle and House Majority Leader Richard Gephardt (D, Mo.) in their respective chambers, would require Japan to reduce the 1991 bilateral trade deficit by 20 percent a year for the next five years. Failure to meet this target would trigger restrictions on the sale of domestically made and imported Japanese vehicles in this country (see *JEI Report* No. 2B, January 17, 1992). USTR Hills said she could not endorse the strategy outlined in the Trade Enhancement Act and argued that it is more important not to constrain trade but to open markets.

Michael Farren, the Department of Commerce's under secretary for international trade, also emphasized that President Bush's Asia trip was intended to demonstrate the importance of trade; on this basis it was "quite successful," he said. Mr. Farren, who negotiated a number of the market access measures announced by Tokyo, outlined several of the trip's objectives and achievements, particularly in the automotive sector. Sen. Bentsen questioned Mr. Farren's assertion that U.S. automotive executives were pleased with the trip's achievements in the automotive area and expressed disappointment that the administration did not come home with enforceable agreements.

Both Sens. Bentsen and Riegle voiced concern that Japanese automotive manufacturers' plans to increase purchases of U.S. parts would benefit Japanese suppliers operating in this country over "traditional" U.S. producers. Mr. Farren noted that it is important for Americans "to recognize a job as a job." He added that a study planned by Washington and Tokyo to examine the sourcing patterns of American and Japanese vehicle manufacturers would provide the information needed to assess the local content issue.

The Finance Committee heard differing conclusions about the trip's achievements from two industry representatives. Robert Galvin, chairman of Motorola, Inc., told the panel that the president's trip was a "strong step forward" that could energize American industry. However, Owen Bieber, president of the United Auto Workers union, characterized the joint economic agenda penned by Japan and the United States during the president's visit as "simply a statement of intentions and hopes, not firm commitments." Mr. Bieber said the UAW does not expect the "action plan" to help narrow either the overall U.S.-Japan trade imbalance or this country's automotive trade shortfall with Japan.

Several committee members stressed the urgency of successfully concluding the Uruguay Round of multilateral trade negotiations. Legislators from both parties emphasized the need for long-term plans for making the United States more competitive. A number also pointed to the importance of spurring the interest and the cooperation of American businesses in boosting their competitiveness. As the second session of the 102nd Congress gets underway lawmakers will be looking to this country as well as to Japan for solutions to U.S. trade and competitiveness problems.

Margo Grimm

Bribery Scandal Complicates Miyazawa's Agenda

Just when the ruling Liberal Democratic Party thought it had laid to rest voters' concerns about the party's sense of morality and fitness for leadership following the Recruit Co., Ltd. influence-peddling affair, another bribery scandal has surfaced to rock the LDP. The January 13 arrest of Fumio Abe, a former cabinet official and high-ranking member of Prime Minister Kiichi Miyazawa's faction, on suspicion of taking bribes from Kyowa Corp., a now bankrupt steel frame manufacturer, has placed Mr. Miyazawa under intense political scrutiny and revived questions about the corruption-prone nature of Japanese politics. Some analysts believe that the prime minister, who was forced to step down as finance minister in late 1988 because of his former secretary's dealings with Recruit, may have to resign once more to accept responsibility for a colleague's conduct — even if he can prove unequivocally that he had no knowledge of, or influence on, Mr. Abe's actions.

In the near term the furor over the Abe bribery scandal appears likely to complicate Diet action on the FY 1992 budget proposal before the April 1 start of the fiscal year. The opposition parties have indicated that they intend to take up as much time as is needed during the 150-day

Table 3: **Japanese Mergers by Industry, FY 1986-FY 1990**

(number of cases)

Industry	FY 1986	FY 1987	FY 1988	FY 1989	FY 1990
Agriculture	9	2	7	11	7
Mining	3	6	3	5	2
Construction	60	61	64	85	122
Manufacturing	243	268	291	309	380
Food Products	24	22	32	26	41
Textiles	15	23	26	24	41
Wood Products	7	14	8	9	16
Paper and Pulp	8	5	9	11	11
Printing and Publishing	10	14	23	22	26
Chemicals and Petroleum	34	36	31	50	40
Rubber	3	3	4	6	1
Nonmetallic Mineral Products	18	15	14	15	28
Steel	10	7	7	8	10
Nonferrous Metals	5	6	4	4	6
Fabricated Metal Products	26	22	15	24	32
Machinery	74	86	99	92	95
Other	9	15	19	18	33
Retail and Distribution	398	409	460	453	551
Real Estate	120	140	143	176	208
Transportation and Communications	50	69	70	79	69
Services	151	142	167	184	217
Finance and Insurance	34	21	19	30	34
Electricity and Gas	1	0	1	0	0
Other	78	97	111	118	161
Total	1,147	1,215	1,336	1,450	1,751

Source: Fair Trade Commission, *Kosei Torihiki Iinkai Nenji Hokoku (Anti-Monopoly White Paper), 1991.*

offering to buy Kojima Securities Co., Ltd. via a stock swap. The bid by the medium-sized brokerage to expand beyond its Tokyo base by acquiring Yokohama-focused Kojima surprised industry analysts.

Faced with slumping trading volumes both on organized exchanges and on the over-the-counter market, many smaller securities firms are expected to post poor results for FY 1991, inviting merger or takeover bids. Observers predict that poor business results will force even top brokerages to restructure their subsidiary brokerages, adding more momentum to the merger wave.

Jon Choy

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The views expressed in this report are those of the authors and do not necessarily represent those of the Japan Economic Institute.

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CAPITOL HILL AND JAPAN: KEY ISSUES, PLAYERS IN AN ELECTION YEAR

SUMMARY

Trade is one of the pressing issues bound to be highlighted as the 1992 presidential campaign and local elections seek to draw distinctions between Democratic and Republican candidates. This country's hefty $42 billion-plus deficit with Japan makes it the most obvious target of the trade debate. The bilateral imbalance not only provides a target for congressional Democrats opposed to the Bush administration's Japan trade policies but also leads legislators from both parties to press for ways to shore up slipping U.S. economic leadership.

Several unknowns could factor into Capitol Hill's trade agenda this year, including the length of the recession and the outcome of multilateral trade negotiations underway in Geneva. Concern about this country's long-term competitiveness and economic stability is a major motivator compelling many in Congress to pursue initiatives intended to resolve broader U.S. trade and competitiveness problems.

Among the readily identifiable trade leaders on Capitol Hill are a number of lawmakers particularly active on the U.S.-Japan trade front. Just as the arena for addressing Japan-related issues extends beyond the congressional committees with jurisdiction over trade, the individuals who are behind such initiatives often approach the subject from diverse backgrounds and with very different objectives and concerns.

Congress in an Election Year

As the second session of the 102nd Congress begins legislators have before them a number of pressing issues, many of which are magnified in timeliness by the upcoming congressional and presidential elections. Congressional Democrats are expected to brandish what they see as an advantage on domestic policy over their Republican counterparts and the Bush administration by pushing such issues as aid for long-term unemployed Americans and improvements to this country's health care system. Both Senate Majority Leader George Mitchell (D, Maine) and Speaker of the House Thomas Foley (D, Wash.) in mid-January outlined a Democratic agenda for this session that includes a national economic recovery package. Republicans generally are backing the economic recovery plan President Bush outlined in his State of the Union address, urging steps toward many of the same goals, but from a different perspective.

With elections just nine months away lawmakers face new pressures to find solutions to national problems. Growing public disillusionment with Congress is adding to legislators' unease this year. An October 1991 *New York Times*/CBS News Poll — conducted shortly after it was revealed that numerous members of Congress had overdrawn their personal accounts deposited in a House-affiliated bank — indicated that 57 percent of the respondents disapproved of the way Congress was handling its job; by late January *New York Times*/CBS pollsters found that this figure had jumped to 71 percent.[1]

Some political analysts point out that public opinion of Congress is fickle and that this response does not necessarily indicate that voters will replace their own representatives; 56 percent of those polled last October said they approved of their representative's performance in Congress. Yet the check-bouncing incident and other Capitol Hill embarrassments have increased the electorate's skepticism. Some observers contend that constituents are more likely to extend their criticism of Capitol Hill to their own representative than they were a year ago. An October 1991 ABC News poll found that only 31 percent of those surveyed were inclined to reelect their incumbent. Moreover, congressional redistricting has shifted many House members' constituencies, making their seats less secure than in previous elections.

The Economy as an Issue

Many variables will weigh into the upcoming congressional and presidential elections, but the state of the U.S. economy in the months before November — currently a key concern for voters — is believed to be the most critical factor. In a *New York Times*/CBS News Poll conducted around the time of President Bush's early January trip to Japan, respondents overwhelmingly cited the economy as the most important problem facing the United States; 81 percent of those polled described the state of the U.S. economy as either "very bad or fairly bad," a marked increase from the number of respondents who chose this description last November.[2]

In uncertain economic times voters generally are more inclined to see their jobs as jeopardized by imports and more likely to favor protectionist arguments, political analysts report. Even when economic problems here ease, voters are likely to remain wary as potentially job-displacing imports once more start increasing. Both congressional and presidential candidates will need to address public concerns about the causes of America's trade and competitiveness problems and then come up with solutions. Certain to dominate this discussion will be Japan, with which the United States had roughly a $42 billion trade deficit last year.

Both politicians and pollsters note that the American public has mixed feelings about this country's trade problems with Japan. (For more on American attitudes toward U.S.-Japan relations, see *JEI Report* No. 31A, August 16, 1991.) A 1991 survey by the Chicago Council on Foreign Relations found that 60 percent of the public saw Japan's economic power as a critical threat to the United States in the next decade. Other polls have revealed similar worries. One conducted in November 1991 by *The New York Times*, CBS News and the Tokyo Broadcasting System found that 52 percent of the Americans polled believed that Japan will be the dominant economic power in the next century.

An October 1991 survey commissioned by Potomac Associates and conducted by Opinion Dynamics further delineated American views on relations with Japan. In the poll 58 percent of the respondents characterized Japan as "generally unfair" in its business transactions with the United States.[3] Yet 53 percent of the respondents said they believed that Japanese companies produce

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better quality products than American firms; 77 percent felt that U.S. companies "still have a lot to learn" about selling their goods in foreign markets, and 61 percent said that foreign competition helps keep down the prices paid by American consumers. Moreover, in a poll released last November by the privately funded Council on Competitiveness, 44 percent of the Americans contacted put "a great deal" of the blame for U.S. competitiveness problems on their own government.[4]

Respondents in the Potomac Associates poll were split 41 percent to 39 percent on whether restricting the availability of foreign products through tariffs or quotas would help or hurt their standard of living. Yet a survey commissioned by the big New York City-based advertising firm Saatchi & Saatchi revealed tough attitudes toward imports of Japanese products; in survey results released last September almost 60 percent of the respondents indicated that they would support legislation significantly restricting imports of made-in-Japan products.[5]

American views on Japanese direct investment in this country seem to be similarly scattered. The Potomac Associates poll found overall support for Japanese direct investment here but concern about investment in specific sectors, including real estate and the financial sector. The November *New York Times*/CBS News poll, in contrast, found that 62 percent of the Americans surveyed believed Japanese investment in the United States threatened U.S. economic independence. Additionally, about 60 percent of the respondents in the Saatchi & Saatchi study said they would favor legislation banning Japanese purchases of American farmland, landmark real estate, large American companies and major U.S. newspapers.

William Watts, president of Potomac Associates, concludes that the October survey indicates that, while Americans recognize there are problems at home, they are willing to accept some of the responsibility. Moreover, he adds, when Americans view Japan, "[T]hey see much that they like, respect, and support. They also see things that give them pause. But that dichotomy is not, as it is often labeled, ambivalence. ... Rather, what we have is a body of opinion that settles on both sides of the ledger, with assets and debits." In a recent interview House Majority Leader Richard Gephardt (D, Mo.) acknowledged this view, pointing out that most Americans reject an "either-or" approach to trade that frames the problem as "being all our fault or all their fault."[6]

While the views of elected officials do not necessarily mirror those of the general public, their actions are likely to be sensitive to constituents' concerns, particularly in an election year. In a December Joint Economic Committee hearing on U.S.-Japan relations, committee vice chairman Rep. Lee Hamilton (D, Ind.) noted, "Any congressman is impressed by the extent to which Japan is on the minds of constituents." His list of what constituents see as problems with Japan included concerns about losing jobs to foreign competition, foreign direct investment in this country, burdensharing, Japan's lack of a forceful role in multilateral trade negotiations, and the bilateral trade deficit.

Congress and the Trade Debate

Both congressional and presidential candidates could face the challenge this year of responding to the public's worries about the U.S. relationship with Japan, a task made more complex because most Americans recognize the two countries' increasing interdependence and the need for finding solutions to many of America's problems right at home. Political analysts note that Republicans and Democrats agree that the United States needs tougher policies to resolve its economic problems; both parties also cite similar objectives in line with boosting U.S. competitiveness. Yet differences on U.S. trade policy are likely to be used to define sides in the 1992 elections.

Several congressional Democrats have escalated their complaints about the White House's trade policy — both overall and with respect to Japan — in recent months, indicating that they hope to make trade an issue with the administration as well as their Republican opponents. *Washington Post* writer Guy Gugliotta notes that there is significant support in Congress for "what could be called an emerging Democratic consensus on trade," the view that "Republican administrations since 1980 have promoted an ideological policy that elevated 'free trade' to the level of dogma, allowing other nations to run roughshod through the world. Tough trade negotiations, with the threat of retaliation and countermeasures, are the only way to ensure a fair shake."[7]

A number of Democrats on Capitol Hill underscore what they see as a direct connection between President Bush's approach to Japan and his failure to address the difficulties facing the U.S. economy. The president's early January trip to Japan has served as a focal point of such criticism (see *JEI Report* No. 2B, January 17, 1992), but one congressional observer says that by making American jobs the focus of the trip the president essentially dropped U.S. economic problems on Japan's doorstep and broadened membership in the group that respectably could engage in "Japan-bashing."[8] Stanley Roth, staff director of the House Foreign Affairs Committee's subcommittee on Asian and Pacific affairs, characterizes this tranformation of the image of "Japan-bashing" as the biggest negative development in U.S.-Japan relations recently and one that contributes to a much less confident appraisal of the relationship than he would have made three months ago.

The Bush trip, Mr. Roth concludes, put the trade issue at the heart of the 1992 campaign early on. Criticisms of Japan's trade practices heard during the trip will be far more likely to dominate Congress than alternative views; election year politics will make it harder "to fend off those who want to attack the relationship," he says. Mr. Roth notes that Congress also may react "viscerally and vehemently" to the criticism of the United States increasingly voiced in Japan.

Many congressional observers concur that Capitol Hill is likely to engage in a tough trade debate this year, and they are skeptical that the discussion will rise above partisan politics or the concerns of certain constituent industries. Most also agree, however, that although there will be a great deal of rhetoric and a possible flurry of tough trade bills, especially Japan-targeted ones, few of these measures are likely to pass. Several key trade questions will be on Capitol Hill's agenda this session, and the outcome of these issues could play into how legislators proceed on Japan-related measures.

The Uruguay Round - The Bush administration long has emphasized the importance of successfully completing the Uruguay Round of trade liberalization negotiations under the General Agreement on Tariffs and Trade. For the most part the promise of stronger, more encompassing international trade rules has kept congressional protectionist initiatives at bay. Yet as a final agreement in the eighth round of multilateral trade talks continues to elude negotiators, trade analysts are becoming increasingly worried that failure in Geneva could propel Capitol Hill into action against what are perceived as foreign unfair trade practices. The weighty U.S. trade deficit with Japan and criticism by some in Congress that Tokyo has not taken a leadership role in the Uruguay Round increase the prospects that Japan-targeted measures will be revived or newly drafted if the multilateral talks break down.

If an agreement is reached in Geneva the White House will have to send the package of measures and the necessary implementing legislation to Congress for approval. Last spring President Bush secured an extension of special procedures for congressional consideration of international trade pacts; the fast-track proviso expedites congressional action and prohibits any changes to multilateral agreements (see *JEI Report* No. 21B, June 7, 1991). Given these restrictions on congressional input, Washington observers speculate that lawmakers opposed to certain parts of the package — farm state representatives against reductions in farm subsidies, for example — may try to block its approval.

Samuel Gilston, editor and publisher of *Washington Tariff and Trade Letter*, expects that when Congress considers implementing legislation for the Uruguay Round package legislators will question the agreement's impact on this country's largest trade problems, including those with Japan.[9] Mr. Gilston notes that the "Draft Final Act" for the round, crafted by GATT's director general and released in late December, contains some provisions that might be useful in countering U.S.-Japan trade problems. Yet some in Congress are wary that the Bush administration will make concessions on key provisions of existing U.S. trade law — such as antidumping rules or Section 301 of the 1974 Trade Act, which addresses unfair foreign trade barriers — to secure a multilateral trade agreement.

This fear was reflected in an early January letter from Sen. Max Baucus (D, Mont.) to U.S. Trade Representative Carla Hills in which he outlined his concerns about the draft agreement, including his perception that "the Uruguay Round does little to address many of the Japanese trade practices that we have struggled for years to address with Section 301 of the U.S. trade law." He added, "Since these trade practices — such as collusion by Japanese *keiretsu* — lie outside the GATT, restrictions on the ability of the U.S. to counter these practices" using the basic retaliatory authority provided under Section 301 "could pose a serious problem."[10] Mr. Baucus, who serves as the chairman of the subcommittee on international trade of the Senate Committee on Finance, has said that the text as currently drafted would not receive strong congressional support.

Sen. Baucus has predicted that Congress will consider "one major trade bill" this year, indicating that implementing legislation for the Uruguay Round could be the vehicle. *Washington Tariff and Trade Letter*'s Mr. Gilston speculates that it is too late to generate a broad, separate trade bill this year. Most congressional observers concur that it is unlikely Congress would find time for a major trade bill this session.

North American Free Trade Agreement - Much of the debate last spring regarding extension of fast-track procedures for international trade agreements centered on the Bush administration's plan to initiate trade talks to bring Mexico into the existing free trade arrangement with Canada (see *JEI Report* No. 39A, October 18, 1991). Negotiations for the North American Free Trade Agreement, which formally started last fall, may wrap up as early as April. Under this scenario the accord could be ready for a congressional vote in early July. U.S. trade officials say President Bush is anxious to submit the proposed agreement to Capitol Hill, where he believes it will be approved.

Yet political analysts argue that NAFTA would provide fuel for a heated trade debate in Congress, a risk they doubt the administration will take in 1992. Senate trade leaders Lloyd Bentsen (D, Texas) and Baucus reportedly have advised the White House that it would be a mistake to present the pact to Capitol Hill this year. Other congressional observers doubt that NAFTA can be completed in time to bring it to a vote in Congress before the session adjourns, currently targeted for early October.

Debate over both the Uruguay Round and NAFTA could offer opportunities this session for Congress to challenge the Bush administration's trade policies as well as to address concerns about U.S.-Japan trade relations. As in the past, however, some in the 102nd Congress already have taken the more direct route of introducing legislation aimed specifically at resolving bilateral trade problems.

Trade Initiatives Focusing on Japan

Among the Japan-related measures to receive significant attention early this session is one of the newest. The Trade Enhancement Act of 1992 is "designed to increase American exports to Japan, and eliminate anticompetitive practices by the Japanese in our market," according to House Majority Leader Gephardt, who formally introduced the bill January 22. Sen. Donald Riegle (D, Mich.) introduced the Senate version the same day. Among the bill's provisions is a requirement that Japan reduce its 1991 trade imbalance with the United States by 20 percent a year for the next five years. If Tokyo fails to meet this target the White House would be forced to cap U.S. sales of domestically made and imported Japanese vehicles in 1992 at what the bill's sponsors estimate is last year's level of 3.8 million units and lower that ceiling every subsequent year that Japan misses the target (see *JEI Report* No. 2B, January 17, 1992).

Chrysler Corp. head Lee Iacocca, one of the Big Three chairmen who accompanied President Bush to Japan, cited the bill as an indication of what Congress is prepared to do to address the U.S.

automotive shortfall with Japan. The bill was cosponsored by a long lineup of automotive state legislators and other colleagues. Yet some on Capitol Hill predict it will be difficult to pass a measure so distinctly linked to aiding Detroit. The initiative is even more unlikely to get the nod from the Bush administration; USTR Hills has criticized the measure for focusing too much on reaching a bilateral balance rather than removing barriers in Japan to American exports.

One observer notes that, although Rep. Gephardt admits the legislation is primarily an automotive industry bill, "he would also like it to serve as a means to debate larger matters — the need to eliminate unfair trade practices, the importance of creating a U.S. industrial strategy, the need to raise trade to 'the top of the national agenda.'"[11]

Super 301 Renewal - Rep. Gephardt and others in Congress also are likely this session to push for a renewal of the Super 301 provision of the 1988 trade act. That provision — which covered 1989 and 1990 only — required the executive branch to identify priority countries for market access talks and authorized the White House to retaliate if negotiations with targeted countries did not result in an agreement to eliminate the cited trade barriers. Last November Reps. Gephardt and Sander Levin (D, Mich.) introduced the Market Opportunity and Reciprocal Enforcement Act of 1991, which would extend and strengthen the Super 301 provision (see *JEI Report* No. 46B, December 13, 1991). The Gephardt measure would make the provision permanent and establish more stringent criteria for identifying priority countries and unfair trade practices.

Some points in the Gephardt-Levin bill are similar to those in the Fair Trade and Export Expansion Act of 1991, introduced early last year by Rep. Levin and Sen. Carl Levin (D, Mich.). The House Energy and Commerce Committee in late November approved a version of that bill that would allow the executive branch more discretion than the original measure (see *JEI Report* No. 43B, November 15, 1991). The House Ways and Means Committee now must consider the legislation. Sens. Baucus and John Danforth (R, Mo.) last October introduced a bill that would extend Super 301 through 1997. Senate observers believe that there could be a great deal of support in that chamber for a Super 301 extension.

Trade in Financial Services - Early this session lawmakers are expected to renew their efforts to reauthorize the expired Defense Production Act, which gives the president authority to procure military supplies during emergencies and to promote the production of strategic materials and technologies. At the end of the first session last fall a measure to reauthorize DPA for three years stalled at the conference committee level because of a number of outstanding issues. Among these was a provision in the Senate DPA version that is intended to improve the overseas business climate for American banks and securities firms by authorizing reciprocal treatment for foreign financial firms operating in the United States.

Lawmakers seem close to resolving their differences on the Fair Trade in Financial Services provision; the measure is likely to be included in some form in the DPA reauthorization, congressional staffers say. The financial services provision also has been offered as a stand-alone bill. Rep. Charles Schumer (D, N.Y.) reportedly will continue to push his version of the measure, introduced last October (see *JEI Report* No. 40B, October 25, 1991).

Foreign Direct Investment — Late last December the White House issued a foreign investment policy statement, the first since 1983; the statement reaffirmed the administration's support for an open foreign investment policy based on the principle of national treatment. Many on Capitol Hill, however, continue to express reservations about certain types of foreign direct investment in this country. Some lawmakers have proposed changes to strengthen the Exon-Florio provision of the 1988 trade act, which gives the president authority to bar foreign takeovers on national security grounds.

One such measure, the Technology Preservation Act of 1991, is designed to compel closer administration scrutiny of foreign purchases of U.S. firms with critical technologies (see *JEI Report*

No. 46B, December 13, 1991). Last November the House Energy and Commerce Committee approved the measure, which also has been referred to the Committees on Banking and Foreign Affairs. Although the Technology Preservation Act has the backing of House Majority Leader Gephardt, Sen. James Exon (D, Neb.) says the problem is not with the provision he helped author but with the White House, which must use the authority provided by the Exon-Florio provision "more forcefully and more frequently."

Burdensharing - The disintegration of the Soviet Union has precipitated another reexamination of U.S. defense spending; the administration's proposed FY 1993 budget, released in late January, calls for the lowest budget authority for defense since FY 1984. Yet while revised priorities have led to reductions in this country's defense spending, Washington may boost its expectations of what U.S. allies should do to share international defense and political burdens. Mr. Roth of the House's Asian and Pacific affairs subcommittee notes that Congress may expect Japan to assume a large share of the costs related to Cambodia's reconstruction, aid for the former Soviet Union and the multibillion-dollar superconducting supercollider in Texas.[12]

Forums for Considering Japan and Trade Issues

Congress has assumed a higher profile on trade issues in recent years. Since the mid-1980s the White House has been under increasing pressure from Capitol Hill to toughen its trade policies. Moreover, some political analysts believe that the 1991 debate over fast-track renewal for international trade talks marked a new level of congressional involvement in determining U.S. trade negotiating priorities.

The White House often uses the threat of congressional action to strengthen a U.S. trade negotiating position. As in other areas, though, the interplay between the executive and the legislative branches can be used to the advantage of both. Yet lawmakers must respond to constituent concerns, and in the trade arena this often translates into a push for measurable responses to very specific problems. Some legislators have achieved a high profile on trade issues because of their fight for constituent industry interests.

Key Committees - Two congressional committees take the lead on international trade legislation: the Senate Committee on Finance, chaired by Mr. Bentsen, and the House Committee on Ways and Means, chaired by Dan Rostenkowski (D, Ill.). The chairmanship of these committees puts both legislators in powerful positions on trade issues. Although Rep. Rostenkowski played a key role in shaping the 1988 trade act, the trade agenda of the Ways and Means Committee often is set by Rep. Sam Gibbons (D, Fla.), chairman of the subcommittee on trade.

Some Washington observers point out that House Energy and Commerce Committee chairman John Dingell's (D, Mich.) drive to expand his panel's purview has pitted this committee against Ways and Means in a contest for jurisdiction over trade legislation. Rep. Dingell, considered a key congressional advocate for the U.S. automotive industry, promotes retaliation against the alleged unfair trade practices of U.S. competitors and has supported U.S. import restrictions on products ranging from cars and steel to shoes. Washington analysts note that such legislation is more likely to be reported from his committee than from Rep. Gibbons' subcommittee on trade.[13]

Sen. Bentsen's leadership on trade issues was particularly evident throughout the 1988 trade bill's arduous path to enactment. The 1988 vice presidential nominee long has argued that trade should be a higher national priority. Following President Bush's January trip to Japan Sen. Bentsen asserted: "The fact is that trade has always been an afterthought for this administration and the previous one." Recently he has called for a comprehensive national economic strategy, while arguing that "an effective trade policy should be part of any strategy for promoting competitiveness." Washington watchers note that the probusiness Texas Democrat's "occasional protectionist rhetoric ... should blind no one to his innate moderation."[14]

Concern about foreign influence on the U.S. political process led Mr. Bentsen to offer amendments to 1990 and 1991 campaign reform legislation that would have prohibited companies with majority foreign ownership from forming political action committees; although included in the Senate's unsuccessful campaign reform bill in 1990, the Bentsen amendment was replaced by a watered-down provision in the 1991 package.

During last year's debate on extending the fast-track proviso Sen. Bentsen expressed support for both the Uruguay Round negotiations and the proposed free trade pact with Mexico and Canada. However, he joined Reps. Rostenkowski and Gephardt in pressing the White House to address congressional worries about the proposed North American Free Trade Agreement.

The Senate Committee on Commerce, Science and Transportation also handles legislation affecting U.S.-Japan economic relations through its involvement in foreign direct investment issues. The committee chairman, Sen. Ernest Hollings (D, S.C.), argues for tough U.S. trade policies and puts up a strong fight for his state's textile interests. Bills he recently has authored include measures disapproving fast-track consideration for multilateral trade agreements and legislation to strengthen the Foreign Agents Registration Act. Sen. Hollings, whom Washington watchers characterize as difficult to pigeonhole politically, may face a tough reelection bid this year.

Another panel that has taken a close look at U.S.-Japan economic relations is the Joint Economic Committee, currently chaired by Sen. Paul Sarbanes (D, Md.) and Rep. Hamilton. Last December the committee, which has no legislative authority, held hearings to examine U.S.-Japan interdependencies and the changing bilateral relationship. In 1990 the committee held a series of hearings to review the economic challenge this country faces from Japan.

Caucuses - Lawmakers also pursue Japan-related issues through numerous caucuses and task forces on Capitol Hill. The largest of these is the Congressional Competitiveness Caucus. Several legislators head the bicameral group of more than 200 members: Sens. Baucus and John Chafee (R, R.I.) serve as Senate cochairs, while Reps. Marcy Kaptur (D, Ohio) and Jim Kolbe (R, Ariz.) are House cochairs. The purpose of the caucus, originated in the late 1980s to review the challenges facing U.S. trade policy, is to provide a forum for education and discussion rather than to advocate specific legislative action — a task generally deemed too unwieldy for the group.

The bipartisan Export Task Force provides guidance on various international trade issues to its roughly 60 House members. The task force rarely takes a position on an issue; its function is to explain what a bill will do, according to a staffer who works with the caucus. Chaired by Reps. Mel Levine (D, Calif.) and Doug Bereuter (R, Neb.), the Export Task Force expects this session to address the Trade Enhancement Act plus ongoing issues, such as NAFTA and the Uruguay Round.

Observers note that the congressional Auto Parts Task Force has played a major role in keeping the U.S. automotive parts deficit with Japan on the administration's trade agenda. Led by Reps. Kaptur, Levin and Nancy Johnson (R, Conn.), the six-year-old bipartisan group's 30-plus members have monitored bilateral talks concerning the parts industry, including the 1986-87 MOSS (market-oriented sector-selective) negotiations. Issues affecting motor vehicle manufacturers are under the scope of the Congressional Automotive Caucus, chaired by Reps. Bob Traxler (D, Mich.) and Dan Burton (R, Ind.). In late January the caucus proposed legislation intended to give sales of American-made cars a boost by providing tax credits of up to $2,000 to each buyer of a car made in this country.

Legislators with a direct interest in the domestic steel industry are represented by the Congressional Steel Caucus, led by Rep. John Murtha (D, Pa.), and by the Senate Steel Caucus, headed by Sen. John Rockefeller (D, W.Va.). Two major issues expected to be covered by the 93-member Congressional Steel Caucus this session are the Uruguay Round and the multilateral steel accord, also being negotiated in Geneva (see *JEI Report* No. 42B, November 8, 1991); as a major player in both of those talks Japan is likely to be a focus of the caucus's discussions.

Congressional staffers note that less obvious groups also could act on Japan-related issues this session. The Northeast-Midwest Senate Coalition and its congressional counterpart, for example, might explore issues affecting the auto industry in those regions.

Key Congressional Players on Trade

Lawmakers active on trade issues have a variety of objectives. House Majority Leader Gephardt has indicated that the trade and competitiveness bills he has authored are part of his attempt to set the agenda for the next Democratic presidential candidate. When Rep. Gephardt campaigned for this position in 1988 he promoted tougher U.S. trade policies; some observers have labeled him Capitol Hill's primary protectionist. The House Majority Leader has said that he sees articulating the Democratic position and agenda as one of the responsibilities of his position. In the trade arena, Washington watchers note, there is significant backing among Democrats in Congress for Rep. Gephardt's views on trade; yet not all Democrats in the House support his approach to the problem.

The Missouri Democrat argues that "blind ideological adherence to the principle of free trade" by the Reagan and the Bush administrations "handcuffed" the United States. He also contends that the Bush administration does not understand the new realities of the U.S. relationship with Japan. Mr. Gephardt promotes constant pressure on Japan as the only effective means of getting Tokyo to change what he deems are its unfair trade practices. Managing the trade relationship and enforcing reciprocal restrictions are among the steps he believes may be necessary to open Japanese markets. An amendment he had hoped to add to the 1988 trade act would have required Washington to take punitive action against countries that run a persistent trade surplus with the United States. Although the amendment was defeated, it was credited with prompting the Super 301 provision. The major trade measures Rep. Gephardt has introduced in the 102nd Congress indicate that he will continue to influence the trade policy debate on Capitol Hill.

Another Missourian who had a guiding role in the 1988 trade act was Sen. Danforth. Washington analysts note that the senior Republican senator from Missouri generally is viewed as a free trader, although he is responsive to allegations of unfair competition affecting constituent industries, including manufacturers of cars, trucks and shoes. According to one observer, "Trade labels don't easily fit" Sen. Danforth, "whose goals seem to be the restoration of credibility to the international trading system and the prevention of a swing to outright protectionism."[15] He has urged successive administrations to make trade a higher policy priority and to use more aggressively the tools provided by U.S. trade law. In a recent Finance Committee hearing Sen. Danforth argued that the U.S. objective should be enforcement of trade rules rather than protectionism. The legislation he introduced with Sen. Baucus last October to renew the Super 301 provision of the 1988 trade act addresses this goal, the senator said.

In 1990 Sen. Danforth, the ranking minority member on the Finance Committee's subcommittee on international trade, pressed the White House to name Japan on that year's Super 301 list; he characterized the decision that April to drop Japan from the list as "deeply disappointing and a serious tactical mistake." At the same time Mr. Danforth has opposed proposals to tighten restrictions on foreign direct investment in this country. He also has disagreed with Senate colleagues who promote a national economic strategy or industrial policy as the answer to U.S. competitiveness problems.

Another senator critical of the administration's 1990 decision not to target Japan for intensive market-access negotiations was Montana Democrat Baucus, the chairman of the Finance Committee's international trade subcommittee. Montana relies heavily on natural resource exports, and Mr. Baucus has pushed hard to open Japanese and other markets for forest products, beef and other agricultural and industrial inputs. Although in his work on Capitol Hill Mr. Baucus is generally supportive of Montana's strong pro-union interests (see Appendix), observers note that the Montana Democrat for the most part has rejected overly protectionist measures, which many unions promote.

Political analysts point out that Sen. Baucus has achieved a solid position in the Senate in a relatively short time. Some note that Sen. Bentsen's increased involvement in issues outside the Finance Committee has allowed Sen. Baucus to strengthen and expand the trade subcommittee's role. Mr. Baucus asserts that "free trade must be a two-way street." He has argued for domestic solutions to U.S. competitiveness problems, but he also is critical of Japanese barriers to trade. In a letter timed to President Bush's Japan trip the Montana Democrat cited *keiretsu* relationships and their role in "blocking American exports in vital sectors" as the single most important issue to be discussed in Tokyo.

Sen. Baucus also has argued that passing legislation to ensure vigorous enforcement of U.S. trade agreements "should be the highest priority of U.S. trade policy." He advocates his Trade Agreements Compliance Act as a means of ensuring that U.S. trading partners do not take advantage of this country. Mr. Baucus has indicated that he will oppose passage of implementing legislation for any Uruguay Round agreement unless the package includes the trade enforcement measure and language to renew the Super 301 provision.

Many on Capitol Hill are concerned about the health of the American automotive industry and the $30.4 billion deficit in automotive products this country ran with Japan in 1990. Few are as anxious about the automotive deficit as those who represent the home states of U.S. motor vehicle and automotive parts manufacturers. One of the toughest critics of policies he believes contribute to this problem is Sen. Riegle. In an early January speech announcing the addition of a U.S./Japan fair trade index to the monthly trade alert he has published since 1985, Mr. Riegle asserted: "By maintaining closed markets at home that block U.S. exports and using import dumping strategies and anticompetitive *keiretsu* practices here in America Japan is steadily destroying a larger and larger part of the U.S. industrial base."

Late last year Sen. Riegle cited "the continuing trade invasion by Japan" as "the central part of our economic problems and the continuing loss of American jobs." The Michigan Democrat admits that this country has made mistakes. He suggests that a long-term competitive strategy to resolve its difficulties should include large-scale investment in research and development as well as in the manufacturing base and the American work force. In addition to government policies to support these efforts, he stresses the need to secure the commitment of the American private sector to contribute to these goals.

Sen. Riegle is said to have one of the most liberal voting records on economic issues in the Senate; his pattern of voting on trade policy, however, points to a strong protectionist stance. The Michigan Democrat was among the first to argue for import restrictions on Japanese vehicles; he also attempted, without success, to push domestic content legislation through the Congress in the mid-1980s. Last spring his reservations about the impact of NAFTA led him to introduce legislation that would allow Congress to amend the proposed pact in five principal areas, including adjustment assistance for displaced workers and rules of origin.

Sen. Riegle also has voiced serious concerns about perceived inequalities between American and foreign banks operating in this country. Japanese banks, which have significant assets in the United States (see *JEI Report* No. 22A, June 8, 1990), are a key target of the Fair Trade in Financial Services Act that Mr. Riegle persistently has attempted to get through Congress. The Banking Committee chairman says that the intent of his bill is "to address the problem of discrimination by certain nations against U.S. financial service firms operating in those nations." The legislation, he adds, would give U.S. negotiators "new leverage in their talks with countries such as Japan, Korea and Taiwan to obtain national treatment in those markets for U.S. banks and securities firms."

Michigan Democrat Carl Levin is among Mr. Riegle's Senate allies in promoting ways to address the U.S.-Japan automotive trade deficit. Sen. Levin has displayed impatience with what he views as Japan's long history of discriminating against U.S. imports as well as the failure of successive administrations to resolve the problem. Citing European limits on Japanese automotive imports (see

JEI Report No. 30B, August 9, 1991), he has proposed placing similar restrictions on Japanese products entering this country. Early last year Sen. Levin reintroduced the Fair Trade and Export Expansion Act to extend a strengthened Super 301 provision through 1995. A provision in the measure requires Super 301 action on practices associated with a sectoral deficit contributing 5 percent or more toward a bilateral trade shortfall. Sen. Levin named this country's automotive parts trade shortfall with Japan as an area that would be subject to the provision.

In his capacity as chairman of the Committee on Governmental Affairs' subcommittee on oversight of government management, Mr. Levin initiated a series of hearings last summer to examine the effectiveness of key lobbying laws, including the Foreign Agents Registration Act. He is expected to introduce legislation this session to establish a unified lobbying disclosure law.

Sen. Levin's brother, Rep. Levin, is similarly active on Japan-related trade issues in the House. As a member of several caucuses that address trade matters and a cochair of the Auto Parts Task Force, Rep. Levin has a broad forum for discussing the trade problems that affect his district, which, before the latest redistricting, was described as forming a semicircle around Detroit. Rep. Levin introduced the companion measure to the Fair Trade and Export Expansion Act; last November he also joined Rep. Gephardt in introducing a separate measure to renew and strengthen the Super 301 provision. Political analysts say that redistricting in Michigan may make it tough for Rep. Levin to hang on to his congressional seat this November.

Outlook

This session Congress will be challenged to do a great deal in very little time. President Bush, in fact, set a March 20 deadline in his State of the Union address for action on his short-term economic recovery plan; even if met, that timetable would leave less than seven months to address other trade and economic agendas. Campaigns and conventions crowd legislators' schedules this year. The limited time they are in Washington will be taken up with complicated struggles over budget priorities and proposals for economic growth. Nevertheless, a variety of trade issues, including renewal of most-favored-nation status for China and this country's trade shortfall with Japan, are certain to receive a share of Capitol Hill's attention.

Lawmakers already have begun to introduce the first of perhaps many bills targeting Japan's trade practices this session. For most measures, however, the chances of passage by Congress are uncertain and the likelihood of enactment by the White House very slim. Nevertheless, the volume of the debate over U.S. trade relations with Japan may rise this session. Even Japan's most vocal critics on Capitol Hill recognize, however, that the United States and Japan have grown more interdependent. Moreover, trade measures that benefit some American industries may harm others. A poll of lawmakers conducted last fall by the *Mainichi Shimbun* and George Washington University's National Center for Communications Studies found that 87 percent believed it is "very important to the United States to maintain good relations with Japan."[16] This underlying congressional perception of the bilateral relationship would appear to bolster the prospects for one observer's prediction that U.S. Japan relations "will muddle through" this session on Capitol Hill.

For more information, contact **Margo Grimm.**

Notes

[1] David Rosenbaum, "Public In Poll Lambastes Lawmakers on Checks," *The New York Times*, October 10, 1991, p. A1, and Robin Toner, "Bad News for Bush as Poll Shows National Gloom," *The New York Times*, January 28, 1992, p. A1.

[2] Robin Toner, "Poll Shows Price Bush Pays for Tough Economic Times," *The New York Times*, January 10, 1992, p. A1.

[3] William Watts, "Domestic Issues Worry Americans," *The Japan Times*, January 7, 1992, p. 26.

[4] John Burgess, "Poll Finds Americans Want Government Role in Business," *The Washington Post*, November 19, 1991, p. B3.

[5] George White, "U.S. Public Wants to Get Tough on Trade," *The Japan Times*, September 15, 1991, p. 21.

[6] E.J. Dionne Jr. and Howard Kurtz, "Political Rivals Denounce Bush Trip as a Failure," *The Washington Post*, January 11, 1992, p. A1.

[7] Guy Gugliotta, "Democrats Seek Broader Trade Policy Debate," *The Washington Post*, January 26, 1992, p. A22.

[8] Comments by Stanley Roth, staff director, House Foreign Affairs Committee, Subcommittee on Asian and Pacific Affairs, in a panel discussion sponsored by the Japan-America Society of Washington and the Asia Society, Washington, D.C., January 27, 1992.

[9] Telephone interview with Samuel Gilston, editor and publisher of *Washington Tariff and Trade Letter*, January 21, 1992.

[10] "Baucus Letter on Uruguay Round," *Inside U.S. Trade*, January 17, 1992, p. 8.

[11] Gugliotta, *op. cit.*

[12] Roth, *op. cit.*

[13] Richard Whalen (ed.), *Trade Warriors: An Inside Look at Trade Activists in Congress — And How to Reach Them* (Washington, D.C.: Worldwide Information Resources, Ltd., 1986) p. 95.

[14] Richard J. Whalen and R. Christopher Whalen (eds.), *Trade Warriors: The Guide to the Politics of Trade and Foreign Investment* (Washington, D.C.: The Whalen Co., 1990), p. 94.

[15] *Ibid.*, p. 115.

[16] Kenichiro Nakajima, "Japanese Masochism is Passe," *Mainichi Shimbun* (Asia Foundation's Translation Service Center, TSC#1532), January 6, 1992.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

APPENDIX

Key Trade Legislators' Voting Records on Japan-Related Bills

Sen. Max S. Baucus (D, Mont.)

Elected 1978 **Seat up** 1994 **Election results** 68%

Relevant Committees and Caucuses	Agriculture, Nutrition, and Forestry Environment and Public Works Finance, Subcommittee on International Trade, chairman Small Business Congressional Competitiveness Caucus, cochair Senate Beef Caucus	
Group ratings	CEI trade vote rating — 26% NJ Economics rating *Liberal* - 73% *Conservative* - 26% AFL-CIO rating — 75%	
Votes on key Japan/trade related bills	1988 Omnibus Trade Bill	Y
	1989 FSX Plane Development/Disapproval	Y
	1989 FSX Plane Development/Restrictions	Y

Sen. John C. Danforth (R, Mo.)

Elected 1976 **Seat up** 1994 **Election results** 68%

Relevant Committees and Caucuses	Commerce, Science and Transportation Finance Senate Republican Policy Committee	
Group ratings	CEI trade vote rating — 50% NJ Economics rating *Liberal* - 35% *Conservative* - 63% AFL-CIO rating — 31%	
Votes on key Japan/trade related bills	1988 Omnibus Trade Bill	Y
	1989 FSX Plane Development/Disapproval	N
	1989 FSX Plane Development/Restrictions	Y

Sen. Donald W. Riegle (D, Mich.)

Elected 1976 **Seat up** 1994 **Election results** 60%

Relevant Committees and Caucuses	Banking, Housing and Urban Affairs, Chairman Budget Finance Northeast-Midwest Senate Coalition	
Group ratings	CEI trade vote rating — 17% NJ Economics rating *Liberal* - 83% *Conservative* - 14% AFL-CIO rating — 94%	
Votes on key Japan/trade related bills	1988 Omnibus Trade Bill	Y
	1989 FSX Plane Development/Disapproval	Y
	1989 FSX Plane Development/Restrictions	Y

Sen. Carl Levin (D, Mich.)

Elected 1978 **Seat up** 1996 **Election results** 58%

Relevant Committees and Caucuses	Armed Services Governmental Affairs Small Business	
Group ratings	CEI trade vote rating — 26% NJ Economics rating *Liberal* - 82% *Conservative* -16% AFL-CIO rating — 100%	
Votes on key Japan/trade related bills	1988 Omnibus Trade Bill	Y
	1989 FSX Plane Development/Disapproval	Y
	1989 FSX Plane Development/Restrictions	Y

APPENDIX

Rep. Richard Gephardt (D, Mo.)

Elected 1976 **Last election results** 57%

Relevant Committees and Caucuses	Budget	
Group ratings	CEI trade vote rating — 23% NJ Economics rating *Liberal* - 92% *Conservative* - 0% AFL-CIO rating — 82%	
Votes on key Japan/trade related bills	1988 Omnibus Trade Bill	*N*
	1989 FSX Plane Development/Passage	*Y*
	1990 Fiscal 1991 Defense Authorization/ U.S. Troops in Japan	*Y*
	1991 Disapproval of Fast-Track Procedures	*N*

Rep. John D. Dingell (D., Mich.)

Elected 1955 **Last election results** 67%

Relevant Committees and Caucuses	Energy and Commerce, chairman	
Group ratings	CEI trade vote rating — 12% NJ Economics rating *Liberal* - 87% *Conservative* - 0% AFL-CIO rating — 82%	
Votes on key Japan/trade related bills	1988 Omnibus Trade Bill	*Y*
	1989 FSX Plane Development/Passage	*Y*
	1990 Fiscal 1991 Defense Authorization/ U.S. Troops in Japan	*Y*
	1991 Disapproval of Fast-Track Procedures	*Y*

Key to Group Ratings

Competitive Enterprise Institute
Favors free enterprise.

National Journal
Indicates liberalism/conservatism of members relative to others in that chamber.

AFL-CIO
Compiled anually by the American Federation of Labor—Congress of Industrial Organizations. High percentage indicates extent to which member is considered pro-labor.

Rep. Sander M. Levin (D, Mich.)

Elected 1982 **Last election results** 68%

Relevant Committees and Caucuses	Ways and Means Congressional Competitiveness Caucus Northeast-Midwest Congressional Coalition Auto Parts Task Force, cochair Congressional Automotive Caucus Congressional Steel Caucus	
Group ratings	CEI trade vote rating — 6% NJ Economics rating *Liberal* - 78% *Conservative* - 22% AFL-CIO rating — 95%	
Votes on key Japan/trade related bills	1988 Omnibus Trade Bill	*Y*
	1989 FSX Plane Development/Passage	*Y*
	1990 Fiscal 1991 Defense Authorization/ U.S. Troops in Japan	*Y*
	1991 Disapproval of Fast-Track Procedures	*Y*

Key to Votes

1988 Omnibus Trade Bill
Vote for passage.

1989 FSX Plane Development/Disapproval
Vote to ban the proposed transfer to Japanese firms of design data to be used for joint development of modified fighter plane for Japanese use. A "nay" vote supported the president's position.

1989 FSX Plane Development/Restrictions
Amendment requiring restrictions on subsequent U.S.—Japan FSX production agreement. A "nay" vote supported the president's position.

1990 Fiscal 1991 Defense Authorization/ U.S. Troops in Japan
Amendment to withdraw 5,000 U.S. troops a year from Japan unless Tokyo pays all costs of stationing U.S. forces there.

1991 Disapproval of Fast-Track Procedures
Adoption of the resolution to disapprove the president's request to extend for two more years fast- track procedures. A "nay" vote supported the president's position.

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JEI

REPORT

A Two-Part Report: A and B

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Japan's Trade Surplus Jumped In 1991 ... Or Did It?

Japan's dollar-denominated customs-clearance trade figures for 1991 seem to send a clear message. The overall surplus jumped 50 percent to $78.2 billion, a ballooning apparently confirmed when expressed in yen (see Tables 1-2). A lesson that appears obvious — because the same figures showed an increase in every quarter of 1991 compared to a year earlier — is that the four-year decline in the Japanese surplus is at an end and the Japanese trade juggernaut is back in business.

The data fall short, however, of making prophets of those analysts who had predicted that Japan's aggregate trade surplus would hit an all-time high as measured in dollars. Furthermore, a closer look at the numbers reveals that the situation is not nearly as bleak as it appears at first glance for those on both sides of the Pacific who would like to see a continued reduction in the Japanese surplus. Clarification requires separating changes in the physical volume of the import and export flows from changes in prices. In 1991 the volume of Japanese exports rose 3.2 percent, slightly below the 3.3 percent growth in import volume. The upshot is that Japan's price-adjusted trade surplus declined modestly last year. The jump in both the dollar- and the yen-denominated imbalances in 1991 stemmed primarily from export price increases and import price reductions.

A primary reason why import prices were lower last year as compared to 1990 was the rapid — and temporary — run-up in oil prices in the fall of 1990. Those price increases, which had been reversed by early 1991, inflated the dollar and the yen values of imports in 1990, thereby reducing the surplus. In 1991 lower oil prices alone accounted for $5.1 billion or 19.6 percent of the increase in the dollar-denominated surplus.

Table 1: **Japan's Total Trade in Dollar Terms**

(in millions of dollars)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1987		$229,221	9.6%	$149,515	18.3%	$79,706
1988		264,917	15.6	187,354	25.3	77,563
1989		275,175	3.9	210,847	12.5	64,328
1990		286,948	4.3	234,799	11.4	52,149
1991 (p)		314,599	9.6	236,367	0.7	78,233
1989:	I	68,227	13.2	51,142	14.9	17,085
	II	67,602	3.7	51,292	8.5	16,310
	III	69,595	3.6	53,048	12.3	16,547
	IV	69,751	-3.5	55,364	14.6	14,387
1990:	I	66,705	-2.2	54,383	6.3	12,322
	II	67,232	-0.5	53,954	5.2	13,278
	III	72,189	3.7	56,547	6.6	15,642
	IV	80,822	15.9	69,914	26.3	10,908
1991:	I	76,384	14.5	61,820	13.7	14,564
	II	74,003	10.1	56,253	4.3	17,750
	III	79,091	9.6	56,994	0.8	22,098
	IV (p)	85,121	5.3	61,300	-12.3	23,821

Table 2: **Japan's Total Trade in Yen Terms**

(in billions of yen)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1987		¥33,315	-5.6%	¥21,737	0.9%	¥11,578
1988		33,939	1.9	24,006	10.4	9,933
1989		37,823	11.4	28,979	20.7	8,844
1990		41,457	9.6	33,855	16.8	7,602
1991 (p)		42,370	2.2	31,851	-5.9	10,519
1989:	I	8,705	12.9	6,516	14.6	2,189
	II	9,222	13.0	6,997	18.2	2,225
	III	9,911	11.0	7,547	20.2	2,363
	IV	9,985	9.3	7,919	29.4	2,067
1990:	I	9,766	12.2	7,941	21.9	1,825
	II	10,449	13.3	8,392	19.9	2,057
	III	10,651	7.5	8,364	10.8	2,287
	IV	10,592	6.1	9,159	15.7	1,433
1991:	I	10,190	4.3	8,251	3.9	1,939
	II	10,226	-2.1	7,771	-7.4	2,456
	III	10,857	1.9	7,831	-6.4	3,025
	IV (p)	11,097	4.8	7,998	-12.7	3,099

Table 3: **Japan's Trade with the United States in Dollar Terms**

(in millions of dollars)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1987		$83,580	3.9%	$31,491	8.4%	$52,090
1988		89,634	7.2	42,037	33.5	47,597
1989		93,189	4.0	48,246	14.8	44,943
1990		90,322	-3.1	52,369	8.5	37,954
1991 (p)		91,543	1.4	53,094	1.4	38,449
1989:	I	22,726	14.4	11,599	15.0	11,127
	II	22,997	6.4	12,064	15.4	10,933
	III	24,117	4.6	12,462	16.8	11,655
	IV	23,347	-7.0	12,120	12.0	11,227
1990:	I	21,661	-4.7	12,753	9.9	8,908
	II	20,938	-9.0	12,861	6.6	8,077
	III	22,933	-4.9	12,729	2.1	10,204
	IV	24,790	6.2	14,025	15.7	10,765
1991:	I	22,324	3.1	13,247	3.9	9,077
	II	20,309	-3.0	13,446	4.5	6,863
	III	23,715	3.4	13,154	3.3	10,561
	IV (p)	25,195	1.6	13,246	-5.6	11,949

Table 4: **Japan's Trade with the United States in Yen Terms**

(in billions of yen)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1987		¥12,148	-10.4%	¥4,582	-6.8%	¥7,566
1988		11,487	-5.4	5,388	17.6	6,099
1989		12,816	11.6	6,632	23.1	6,184
1990		13,057	1.9	7,586	14.4	5,471
1991 (p)		12,325	-5.6	7,161	-5.6	5,164
1989:	I	2,899	14.1	1,478	14.6	1,421
	II	3,139	16.0	1,648	25.9	1,491
	III	3,436	12.2	1,773	25.0	1,663
	IV	3,342	5.2	1,733	26.4	1,609
1990:	I	3,171	9.4	1,862	26.0	1,309
	II	3,254	3.7	2,000	21.4	1,254
	III	3,384	-1.5	1,885	6.3	1,498
	IV	3,249	-2.8	1,838	6.1	1,411
1991:	I	2,978	-6.1	1,767	-5.1	1,211
	II	2,807	-13.7	1,857	-7.2	950
	III	3,254	-3.8	1,808	-4.1	1,446
	IV (p)	3,285	1.1	1,728	-6.0	1,557

Japan's relatively weak trade performance in 1991 is evident in a preliminary analysis of changes in import and export market shares last year. While definitive figures are not available, the growth in import volume in 1991 suggests that foreign products probably increased their penetration of the Japanese market since domestic industrial production rose only 2.1 percent against the 3.3 percent rise in import volume. Similarly, Japan's exporters may have given up market share in some overseas markets. For example, dollar-denominated exports to the United States moved up a scant 1.4 percent, while yen-denominated exports dropped 5.6 percent (see Tables 3-4). Assuming that price increases for products destined for the United States were roughly equal to those headed for other foreign markets, the data suggest that the volume of exports to this country fell at least a couple percentage points last year. Given the preliminary figure of a price-adjusted 0.7 percent decline in U.S. gross domestic product last year, it is safe to conclude that Japanese penetration of the American market declined modestly.

Japan's exports to Asia, however, rose impressively by any standard last year, climbing 17.9 percent as measured in dollars. The $104.8 billion worth of goods shipped to Asia (including the People's Republic of China) exceeded those to the United States for the first time in recent memory. Asia already was a larger source for Japanese buyers than the United States, and a 9.5 percent gain in purchases in 1991 — to $73 billion — increased that lead. Last year Asians bought 33.3 percent of Japan's exports and supplied 30.9 percent of its imports. For this reason the 3.2 percent growth in the volume of Japanese exports has to be considered in light of the rapid expansion in Asian economies.

Japan's fourth-quarter worldwide trade figures showed a slightly different pattern than for 1991 as a whole. The period's overall dollar-denominated trade surplus more than doubled compared to October-December 1990. Even the price-adjusted surplus registered a significant increase; exports increased 2.5 percent in real terms against a 1.6 percent rise in the volume of imports. The fourth-quarter import figures no doubt reflected Japan's widening economic slowdown toward the end of last year; in each of the last three months of 1991 industrial production was 1 percent or more below the same period in 1990. Finally, exports to the United States grew slightly by yen and dollar measures, while imports by the same yardsticks declined. The result was a modest increase in Japan's yen- and dollar-denominated surpluses with this country; however, the surplus as measured by volume probably showed a decline, although that type of data is not available.

In short, the increase in Japan's dollar-denominated surplus in 1991 was rooted in price changes for such commodities as oil but also reflected sluggish economic activity in Japan and its trading partners. Weakening conditions in Japan tended to drive down import demand, a trend that appeared to grow more pronounced as the year progressed. While American and European import demand also took a hit from macroeconomic conditions, thus depressing Japanese exports, Asian demand for Japanese goods increased substantially. This combination pushed the dollar-denominated trade surplus up significantly even while the price-adjusted surplus was declining.

These trends may become clearer this year. On the plausible assumption that average economic growth in Europe, North America and Asia outside Japan will exceed that of Japan in 1992, Tokyo could find itself reporting a growing trade surplus as measured both in dollars and volume this year.

Douglas Ostrom

Miyazawa Scores — Then Loses — Diplomatic Points

To many observers it came as no surprise that Prime Minister Kiichi Miyazawa, who brought to office last November an impressive array of foreign policy and economic credentials, would articulate Tokyo's interest and willingness to raise its international political profile. Attending the unprecedented summit January 30-31 of the five permanent and 10 rotating members of the United clearly pushed cooperation on certain matters forward, resolving the questions of early consultation and solicitation of foreign participation probably would smooth the way for future efforts.

Jon Choy

Politics Complicate MITI's Car Quota Decision

Transpacific politics have kept the cap on Japan's U.S.-bound car shipments in place since at least 1988. The nine Japanese motor vehicle exporters know this; so do the Big Three U.S. car and truck manufacturers, the United Auto Workers union and automotive-state legislators on Capitol Hill. Even Ministry of International Trade and Industry policymakers will concede that the economic rationale for limiting car exports to the United States had disappeared by the late 1980s, eliminated by weakening market conditions and rising North American production of the best-selling Japanese models. Japan's automotive exporters last filled the aggregate 2.3-million-unit quota in FY 1986. In the year through March 1988 they missed it by 3.7 percent or 85,851 cars. By FY 1990 the margin of undershipment had reached 19.6 percent, the equivalent of 450,369 units. During the current 12-month restraint period exports could be 28 percent or so under the ceiling, or about 646,000 units short, if April-November 1991 shipment trends hold up through March.

While these numbers are a decisive case for ending the restraints, automotive industry analysts and trade watchers on both sides of the Pacific take another year of managed trade in cars as a given. In their view the 1991 sales results for General Motors Corp., Ford Motor Co. and Chrysler Corp. and the consensus 1992 forecast for the U.S. car market make continued limits inevitable.

By any yardstick last year was a disaster for the three American automotive makers. Overall U.S. car sales contracted 12 percent to less than 8.2 million units, the smallest total since the recession year of 1982 and 28.4 percent below 1986's record performance (see Table). Detroit gladly would have traded 1982's volume for 1991's since already hard-hit sales of Big Three-badged cars dropped another 14.2 percent to fewer than 5.3 million units — a level last seen in the late 1950s. As if that was not bad enough, GM, Ford and Chrysler sold only 4.6 million-plus cars made in their own North American or Mexican plants.

Japanese nameplates were not immune to U.S. market conditions last year. After bucking 1990's overall drop, sales of Japanese-badged cars fell 4.4 percent to under 2.5 million units. None of Japan's big manufacturers escaped the downturn, but seven of the nine companies selling cars here gained market share. Those gains gave Japanese nameplates another 2.4 percentage points of market share, pushing them across what most analysts consider to be the politically dangerous 30 percent market share line to 30.2 percent.

U.S. car sales are expected to strengthen in 1992, particularly in the second half, but many industry watchers think American car manufacturers are in for another grim year. That outlook plus the anti-Japan rhetoric recently heard in Detroit and on Capitol Hill put MITI decisionmakers in a tough spot. They apparently realize that a simple extension of the 2.3-million-unit cap on Japanese car exports to the United States will not work politically this year, but they see drawbacks to the primary alternative — cutting the quota. First and foremost, lowering the ceiling could send the wrong signal to the United States. It might imply that Japan's automotive industry is the cause of Detroit's problems or at least bears part of the responsibility. More troubling, such a move could encourage the drive for a cap on Japan's overall share of the U.S. car market (see *JEI Report* No. 2B, January 17, 1992) by suggesting that Tokyo is ready to cut a deal.

Then there is the question of the size of the cut. The most frequently cited figure is 500,000 units. MITI officials and Japanese automotive industry executives no doubt recognize that trimming the quota to 1,800,000 cars would be dismissed in the United States as an empty gesture because that cutback would have no effect on trade. The reaction probably would be the same if the quota were

U.S. Retail Car Sales, 1983-91

(units)

Manufacturer/Seller	1983	1984	1985	1986	1987	1988	1989	1990	1991
Japanese Imports									
Toyota Motor Corp. (incl. Lexus)	542,877	513,820	577,181	601,939	562,274	584,284	464,551	430,668	409,398
Honda Motor Co., Ltd. (incl. Acura)	350,670	374,819	406,413	458,268	421,688	393,360	393,630	390,761	321,270
Nissan Motor Co., Ltd. (incl. Infiniti)	521,902	485,298	535,372	493,549	405,996	360,745	397,094	336,366	300,052
Mazda Motor Corp.	173,388	169,666	211,093	222,716	206,354	219,002	184,583	153,055	144,287
Mitsubishi Motors Corp.	32,755	39,104	49,734	49,436	67,954	69,975	79,751	99,630	92,383
Fuji Heavy Industries, Ltd. (Subaru)	156,840	157,385	174,100	183,242	175,864	155,946	136,112	92,729	55,707
Isuzu Motors Ltd.	20,731	17,233	26,953	38,910	39,587	24,520	16,296	5,837	13,301
Daihatsu Motor Co., Ltd.	0	0	0	0	0	11,460	15,111	10,630	6,202
Suzuki Motor Co., Ltd.	0	0	0	0	0	524	6,008	6,525	4,846
Isuzu Motors Ltd./General Motors Corp.	0	2,077	53,593	99,380	76,852	68,347	62,877	86,257	77,186
Mitsubishi Motors Corp./Chrysler Corp.	103,569	91,718	105,213	135,528	120,337	113,800	98,280	65,263	65,524
Suzuki Motor Co., Ltd./General Motors Corp.	0	10,927	31,267	60,983	60,359	48,088	52,792	42,488	13,882
Domestic Makes*									
General Motors Corp.**	4,053,561	4,587,508	4,607,458	4,532,798	3,555,538	3,641,542	3,276,941	3,141,157	2,783,692
Ford Motor Co.***	1,571,321	1,979,317	2,070,392	2,066,507	2,019,783	2,205,636	2,041,808	1,845,895	1,527,168
Chrysler Corp.****	1,034,973	1,177,253	1,263,385	1,246,311	962,057	1,062,782	917,506	795,096	636,994
Volkswagen of America Inc.	85,045	73,838	77,535	73,912	61,064	24,939	0	0	0
Honda of America Manufacturing, Inc.	50,402	133,601	145,976	235,247	316,618	375,625	389,472	464,118	482,097
New United Motor Manufacturing Inc./ General Motors Corp.	0	0	35,594	170,507	134,956	96,868	89,710	109,631	98,433
New United Motor Manufacturing Inc./ Toyota Motor Sales USA Inc.	0	0	0	7,281	44,853	58,579	81,201	135,953	141,612
Nissan Motor Manufacturing Corp. U.S.A.	0	0	39,794	52,602	119,678	112,125	103,134	109,575	112,800
Mazda Motor Manufacturing (USA) Corp./ Mazda Motor of America, Inc.	0	0	0	0	1,671	31,331	41,584	72,657	77,356
Mazda Motor Manufacturing (USA) Corp./ Ford Motor Co.	0	0	0	0	0	77,763	133,650	103,062	76,295
Toyota Motor Manufacturing, U.S.A., Inc.	0	0	0	0	0	13,775	131,187	212,587	191,011
Diamond-Star Motors Corp./ Mitsubishi Motor Sales of America, Inc.	0	0	0	0	0	0	32,018	49,877	69,496
Diamond-Star Motors Corp./Chrysler Corp.	0	0	0	0	0	0	28,243	69,441	66,334
Subaru-Isuzu Automotive Inc./ Subaru of America, Inc.	0	0	0	0	0	0	0	15,818	49,345
CAMI Automotive Inc./American Suzuki Motor Corp.	0	0	0	0	0	0	0	0	684
Domestic Makes Built by Big Three	6,659,855	7,744,078	7,905,641	7,675,109	6,402,422	6,735,329	5,984,652	5,500,014	4,706,792
Domestic Makes Built by Japanese Affiliates	50,402	133,601	221,364	465,637	617,776	766,066	1,030,199	1,342,719	1,365,463
Total Japanese Imports	1,902,732	1,862,047	2,170,919	2,343,951	2,137,265	2,050,051	1,907,085	1,720,209	1,504,038
Total Imports	2,357,652	2,379,567	2,777,319	3,197,836	3,111,851	3,017,230	2,698,274	2,453,108	2,104,055
Total Domestic Makes	6,795,302	7,951,517	8,204,721	8,214,662	7,081,262	7,526,334	7,014,851	6,842,733	6,072,255
Total Market	9,152,954	10,331,084	10,982,040	11,412,498	10,193,113	10,543,564	9,713,125	9,295,841	8,176,310
Market Share of Japanese Imports	20.8%	18.0%	19.8%	20.5%	21.0%	19.4%	19.6%	18.5%	18.4%
Market Share of Japanese Imports and Domestic Makes Built by Japanese Affiliates	21.3%	19.3%	21.8%	24.6%	27.0%	26.7%	30.2%	33.0%	35.1%

*Includes cars built in Canada by the Big Three as well as by Japanese transplants and cars produced in Mexico by the Big Three.

**Starting in 1985 includes the Geo Nova/Prizm made by New United Motor Manufacturing Inc.

***Starting in 1988 includes the Ford Probe made by Mazda Motor Manufacturing (USA) Corp.

****Starting in 1989 includes the Plymouth Laser and the Eagle Talon and Summit made by Diamond-Star Motors Corp.

Source: *Automotive News*

returned to its original (FY 1981-FY 1983) level of 1,680,000 units since exports in the April 1991-March 1992 period are likely to come in around that number. A lower volume would create administrative difficulties for MITI officials in charge of making company-by-company quota allocations as well as planning problems for corporate marketing managers, but a figure below FY 1991's expected shipment level could send an acceptable message to the U.S. automotive industry and its supporters on Capitol Hill — one of shared sacrifice.

Susan MacKnight

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The views expressed in this report are those of the authors and do not necessarily represent those of the Japan Economic Institute.

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REPORT

A Two-Part Report: A and B

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OPPORTUNITIES IMPROVING FOR FOREIGN WORKERS IN JAPAN BUT STILL LIMITED

SUMMARY

Pressure for better market opportunities in Japan for foreign suppliers of goods and services and offshore investors is routine. In recent years, however, Tokyo has had to field a different type of market access demand — to open the Japanese labor market to foreigners. This demand has touched off an unusual domestic debate, one that melds new lines of reasoning with arguments raised when the market target is the more common variety and that involves a different array of interest groups than the typical market access demand.

Domestic concerns about an influx of unskilled laborers and worries about the growing number of foreigners who stay in Japan and take unskilled jobs, sometimes illegally, continue to color one side of the debate. Offering another perspective are small and midsized businesses that cannot find enough workers even though the economy is close to or actually in a recession. A third element is represented by workers from developing countries who want to improve their skills by gaining experience in factories that produce low technology products, most of which are operated by the very type of company looking for workers.

Hoping to carve out a middle ground, Tokyo has decided to introduce a program that will allow foreign workers who meet certain requirements to get in-house training over a nine-month period and continue to work for the host company for up to 15 months. This approach reflects the advice of a government administrative reform panel last December. A semigovernmental organization established last October will backstop participating workers and companies when the training program is put in place late this year.

A Primer on Who Can Work in Japan

To work legally in Japan a person must either be a Japanese citizen or satisfy certain eligibility requirements set forth in the country's immigration regulations. The foreigners who have the easiest time qualifying for work permits are permanent residents and their dependents plus a variety of people considered to be professionals or skilled workers (see Table 1). Permanent residents, most of whom were forced to move from Korea and Taiwan during the Japanese occupation period,

Table 1: **Foreigners Entering Japan by Residence/Job Status Plus Region of Origin, 1990**

	Total	Asia	Europe	North America	South America	Africa	Oceania	Soviet Union
Diplomats	10,762	3,282	2,418	2,516	493	1,014	579	456
Government Officials	15,629	7,843	1,963	3,298	270	780	884	578
Professors	3,101	452	810	1,703	16	7	104	9
Artists	2,668	1,258	678	619	17	13	61	14
Clergy	4,894	817	860	3,081	19	10	99	7
Journalists	1,380	207	481	637	4	2	44	5
Managers	40,974	8,583	14,154	16,575	294	84	1,202	71
Lawyers/Accountants	568	23	136	374	—	—	34	1
Medical Personnel	695	649	12	31	2	—	1	—
Researchers	693	305	178	187	3	7	3	10
Instructors	16,430	443	2,984	11,813	23	22	1,137	8
Engineers	3,753	1,618	570	1,456	32	19	54	4
Social Scientists	22,956	10,882	3,257	7,377	481	54	867	19
Intrafirm Transfers	2,721	1,125	610	866	30	3	68	18
Entertainers	75,698	49,644	10,633	11,524	1,040	313	976	1,538
Other Skilled Workers	3,454	2,791	588	51	7	1	13	1
Other Performers*	2,595	1,367	432	659	35	29	30	43
Visitors**	2,705,538	1,568,675	428,436	548,589	70,108	7,804	59,298	20,847
College Students	55,935	50,262	1,746	2,773	531	212	315	63
Precollege Students	47,150	43,879	1,564	1,092	89	44	451	9
Trainees	41,090	33,526	2,201	1,493	2,217	1,162	395	83
Dependents	51,933	26,092	9,806	13,910	555	165	1,209	129
Designated Activities	5,973	1,432	30	1,691	20	17	2,739	44
Permanent Residents	91,464	85,158	2,687	2,831	163	47	204	39
Nonnative Relatives of Nationals	104,369	80,058	4,203	7,571	11,465	272	597	92
Children/Spouses of Permanent Residents	19,491	18,466	279	546	82	5	34	4
Others***	172,556	165,536	599	1,262	4,867	9	149	43

Notes: Not all categories add up to the total because in some cases no nationality was listed.
The figures do not necessarily correspond with the number of visas issued or foreigners' registration records at local government offices since some foreigners had multiple-entry visas and, thus, were counted more than once.

*People who do not receive salaries while in Japan.
**People who can stay in Japan no more than 90 days.
***Includes long-term residents, people residing permanently under special arrangements, and refugees and other people granted temporary protection.

Source: Management and Coordination Agency, Statistics Bureau, *Statistical Yearbook of Japan, 1991*.

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face only a few restrictions on the types of jobs they can hold. (The same limitations apply to their descendants.) Some government positions, for example, are not open to permanent residents (see *JEI Report*, No. 2B, January 18, 1991).

The employment door in Japan also is fairly wide open for foreigners living in Japan with a Japanese spouse or the child of such a couple, although even in this situation the noncitizen has to periodically renew his or her visa — every three months, six months, year or three years, depending on the person's status. Another group that can obtain a work permit relatively easily includes descendants of Japanese emigrants, many of whom have dual citizenship. Over the last few years there has been an influx of Brazilians and Peruvians whose Japanese parents had registered them as Japanese citizens at the Japanese consulate in their respective land of birth. These people generally have sought temporary employment, even taking unskilled jobs — a category of work for which no other foreigners legally can obtain visas.

Temporary residents, who can stay in Japan no more than three years without renewing their visas, are classified in four general categories: workers who have a job listed in the immigration rules; students in universities or colleges; students in Japanese language or vocational training schools; and trainees in public or private institutions. Students are allowed to work part-time, defined as less than four hours a day, if they receive permission from the immigration office. Trainees are prohibited to work; instead, they receive an allowance for living expenses of ¥30,000 ($222 at ¥135=$1.00) to ¥180,000 ($1,333) a month, either from the Japanese government or the host company.

Under a June 1990 revision of Japan's immigration regulations (see *JEI Report* No. 23A, June 15, 1990) more job classifications were opened to foreign temporary residents. The 16 currently open are: diplomacy, government business other than diplomacy, teaching in higher educational institutions, artistic activities, missionary work, journalism, investment and business management, legal and accounting services, medical services, research other than teaching in educational institutions, teaching at elementary or high schools, providing professional techniques based on science and technology, business related to social science knowledge and/or international activities, intrafirm assignments, entertainment (such as singing, dancing and sports events), and other skilled labor with unusual talents (for example, a chef specializing in a foreign cuisine.)

Excluding diplomats and other government officials, foreigners coming under the temporary workers' category and entering Japan for the first time accounted for 106,936 visas during the first 12 months that the new immigration rules were in effect. (The figures listed in Table 1 do not correspond with the number of newly issued entry visas since some people with multiple-entry visas entered more than once during the period.) Of these newly issued visas 82 percent went to entertainers. Figures for 1990, listed in Table 1 — which includes only half a year's data generated under the expanded classification system, show that 2,721 visas were issued to people whose foreign-based companies sent them to an affiliated office in Japan or who worked for the overseas subsidiaries of Japanese companies and came to Japan to work at headquarters.

Professionals who are not employed by offshore subsidiaries of Japanese businesses or by foreign companies operating in Japan typically have trouble obtaining visas that will allow them to work unless they can meet some fairly stiff requirements. For example, to obtain an extended-stay visa for technical or scientific work an applicant must be a university graduate in the sciences or a technical field with more than 10 years of relevant job experience. Foreigners who apply for visas under the specialized skills category also are required to have a certificate attesting to their special abilities as well as over 10 years of job experience. Perhaps at the extreme are foreign students who graduate in the sciences or technical fields from Japanese universities or vocational training schools but cannot work in Japan because they do not have adequate job experience. Although government officials said when they amended the immigration regulations that they expected to allow more foreign specialists to work in Japan, only 4,853 visas were issued under the relevant categories over the June 1990-June 1991 period.

Keeping Track of Foreign Workers

Obviously, not all of the foreigners who enter Japan (about 3.5 million in 1990) want to stay and work there. Most visitors are tourists or business people who are there less than 90 days. Some foreigners do remain in Japan to work or study, although determining their exact numbers is difficult because no specific survey addresses how many foreigners, including those working illegally, are in Japan. Some immigration data, however, suggest that growing numbers of foreigners work there.

Japanese immigration regulations require all foreigners who plan to stay in Japan more than 90 days to get a special visa as well as to register at the nearest local government office. The only exceptions to the registration requirement are diplomats and other government officials as well as their family members plus U.S. military personnel stationed in Japan and their family members.

Local government records show that as of the end of 1990 almost 1,075,000 foreigners had registered as required. Of the names on file 645,000 had permanent-resident status, including 620,000 Koreans and Taiwanese. The remaining temporary residents included foreigners who had a Japanese spouse or their children as well as descendants of Japanese emigrants (80,000); overseas residents who either themselves held a qualified working visa or were living with someone who did (230,000); or foreigners who were in Japan for nonwork-related purposes, such as studying and training, and their dependents (120,000).

Between 1985 and 1990 the number of people seeking visas for work, training or study in language or vocational training schools more than doubled. Foreign students granted visas to study at Japanese universties or colleges came close to doubling (see Table 2). The number might have been much greater for students in language and vocational schools except that, after visas for this purpose reached 35,107 in 1988, qualifications were tightened. Immigration officials acted to stem the inflow of students applying to Japanese language schools because they suspected a number of unskilled workers were only pretending to study Japanese and instead were working.

Table 2: **Number of Foreigners Entering Japan for First Time for Work, Study or Training, 1982-90**

Year	Employees*	Students at Universities and Colleges	Students at Language and Vocational Schools	Trainees
1982	33,634	3,410	2,556	9,978
1983	34,582	3,912	3,448	11,929
1984	42,775	4,329	4,140	13,262
1985	43,994	4,797	8,942	13,987
1986	54,736	5,419	12,637	14,388
1987	69,183	5,812	13,915	17,081
1988	81,407	6,435	35,107	23,432
1989	71,978	7,777	18,183	29,489
1990	94,868	9,528	20,851	37,566

*Excludes permanent residents as well as diplomats and other foreign government officials and U.S. military service people and their families.

Source: Ministry of Justice

The Problem of Illegal Workers

Prosecution of foreigners caught working illegally in Japan jumped nearly fivefold between 1985, when 5,629 cases were brought, and 1990, when 29,888 were filed. Moreover, as a result of tightening immigration inspections, 20,719 foreign visitors arriving at Tokyo's Narita International Airport were not allowed to enter Japan last year; that number was more than double the 1990 figure of 9,669. Although a large majority of those refused entry came from Asia and the Middle East, the nationalities of people suspected of trying to enter Japan to work illegally represented 81 countries.

The number of people actually deported or refused entry represents only a portion of the foreign residents thought to be working illegally in Japan. The Ministry of Justice estimated that 160,000 foreigners were living illegally there as of June 1991. Although the ratio of foreign workers to the total population of Japan is relatively small compared with the ratio in the United States or European nations, foreign nationals often are more visible in a homogeneous nation such as Japan. Another factor, not unfamiliar to Americans, is that foreign workers tend to live near people of the same nationality; this concentration makes their presence more noticeable. Some Japanese have grown correspondingly more concerned about an influx of foreign workers in their neighborhood.

Determining whether foreign residents are working illegally is difficult at best. Most illegal workers come to Japan disguised as tourists. Tokyo has concluded tourist visa exemption agreements with many countries; these pacts allow visitors planning to stay less than 90 days to enter the country without a visa. Tourists who stay beyond the authorized 90-day period are considered to be illegal aliens and are assumed to be working illegally. Neither visa records nor foreigner registration records track these illegal workers since it is unrealistic to expect them to register their status at a local government office.

Also considered to be illegal workers are foreigners who have a valid temporary resident visa but do unauthorized work. Some foreigners with an entertainer's visa, for example, reportedly also work as waiters or hostesses. In some cases foreign students, who are allowed to work only up to four hours a day, end up putting in more time to meet tuition or living expenses. A January 1992 survey by the Management and Coordination Agency pointed out that some trainees are more or less full-time workers rather than part of a government-supervised but company-hosted training program.

Employment Prospects for Legal Foreign Workers

Information about the working conditions of foreigners in Japan comes in bits and pieces. An annual survey by prefectural labor audit offices showed that in 1990 only 74 of the 12,276 surveyed firms — or 0.6 percent — employed more than one foreign worker. The number of foreign workers in the 74 firms totaled just 609. Missing from this nationwide survey, however, is any breakdown by industrial sector and/or size of company that employs foreign workers.

In a separate survey covering 1990 the Ministry of Labor focused on foreigners employed under a qualified temporary work visa; omitted from the data were permanent residents and illegal workers. Among the 4,500 companies with more than 100 employees contacted by the ministry, 3,965 answered the questionnaire. The survey showed that 10.3 percent of the respondents had hired at least one foreign employee; on average 6.1 foreign workers were employed by those companies that did hire foreigners.

Not surprisingly, larger companies generally were more likely than smaller ones to hire foreign nationals. The survey found that 66 percent of the surveyed companies with more than 5,000 employees hired at least one foreigner — 14.4 foreigners per business on average. Among the next-largest firms, those employing 1,000 to 4,999 people, only 26.3 percent had foreign workers on the payroll; their average was 7.4 foreigners per company. Even fewer medium-sized firms (those with 300 to 999 workers) had foreign employees, but their percentage of 14.2 percent was more than twice the 6 percent rate for firms employing 100 to 299 workers. Having offices overseas was no indication that firms would hire foreign workers in Japan; only 28.9 percent of the companies in that category had foreign employees at home.

By sector the most likely employers of foreigners were in financial services or some other services; 14.3 percent of these firms had hired foreign workers. Retail and wholesale firms and manufacturing companies ranked next, with 10.8 percent and 10.7 percent, respectively, employing foreign workers. The transportation and construction industries employed the fewest foreigners, 4.7 percent and 4 percent, respectively. The apparent scarcity of foreign workers in the transportation and construction industries stems, in some part, from the fact that the figures do not include unskilled foreign laborers — who legally cannot work — as well as the sample's exclusion of small companies.

The survey also indicated that 32.8 percent of foreign employees worked part-time while 29.5 percent had full-time status; the remaining 37.7 percent had short-term contracts. By job category technical positions, like data processing, covered 24.6 percent of the surveyed foreign workers. Next were translators and interpreters (21.1 percent). Market and other business research positions employed 20.6 percent, followed by 17.6 percent in general business operations, 16 percent in sales, 7.6 percent in language teaching and 7 percent in other professional jobs, like legal services.

Companies that employed foreign workers generally had a good impression of them. Over the past three years 67.8 percent of the MOL-surveyed firms that had hired foreigners increased their numbers; of these firms 40.5 percent planned to expand hiring of foreign workers in the next three years. Most employers said they appreciated foreign nationals not only for their language skills but also for their professional abilities and their way of thinking, influenced as it is by a different cultural background.

Conditions for Illegal Workers

Monitoring the working conditions of unskilled laborers illegally employed in Japan always has been difficult but, ironically, the June 1990 changes in the country's immigration regulations have made this job harder because now employers that hire people without a work visa can be punished along with the illegal workers themselves. Despite the tightened immigration rules, unskilled foreign laborers continue to be hired, particularly in what are known as the 3K industries — those that are *kiken* (dangerous), *kitanai* (dirty) and *kitsui* (hard). Of the 24,176 male foreigners prosecuted for working illegally in 1990, the latest year for which data are available, 6,774 were construction workers and 7,620 were factory workers. Since Tokyo committed to increased funding of public works in the Structural Impediments Initiative talks with Washington, analysts expect the construction industry to have trouble finding enough workers for some time. Even though the Japanese economy may be in a recession (see *JEI Report* No. 5B, February 14, 1992), construction companies and small and midsized manufacturers are expected to continue to struggle with chronic labor shortages. This stems in part from the higher standard of living in Japan; that makes many Japanese workers disdain 3K-type work even if offered a higher salary than what they are making.

Further complicating government's ability to monitor illegal foreigner workers is the fact that they generally are hired on a daily or a monthly contract basis and frequently move from site to site. According to a voluntary group that tracks accidents in which foreign workers are involved, more than 150 cases were reported to their hotline from January to September 1991; in 1990 only 42 cases were reported. A majority of these accidents were related to 3K-type jobs. Although workers' compensation insurance can be extended to foreign nationals regardless of their legal status, many foreigners illegally staying in Japan are unware of this option; even for those who do know, both employers and employees tend to hesitate to apply for workers' compensation for fear that they will expose their position and become a target of prosecution. The January 1992 Management and Coordination Agency survey listed only 115 cases among those filed in 1990 as involving foreign employees requesting workers' compensation. Of these, 81 concerned illegal workers.

Unlike workers' compensation insurance, access to national health insurance coverage and public services, such as education, depend primarily on whether a worker has registered at his or her local government office. Neither a foreign resident without the appropriate visa nor any family members can take advantage of public services without registering. The current provision of public services in Japan falls short of handling effectively human rights issues affecting illegal foreign residents.

Administrative Reform Panel Recommendation

Under orders to look at foreign workers in Japan and the availability of public services for them from the goal of making Japanese society more internationally oriented, a government administrative reform panel issued a modest recommendation for change this past December. Noting the influx into Japan of illegal unskilled foreign laborers, the panel suggested in principle that the government's current immigration policy be maintained but that some unskilled workers from developing countries be allowed to stay and work over a two-year period in line with a new technical training program.

Current job training schemes are considered ineffective to deal with unskilled foreign workers because these programs were not necessarily set up to meet the varied needs of both a foreign work force and Japanese firms in need of unskilled labor. Job training now is carried out mainly under either government-sponsored economic cooperation programs run by the Japan International Cooperation Agency or as part of private-sector programs in which parent companies host trainees from their overseas subsidiaries or other affiliated firms (see *JEI Report* No. 43A, November 9, 1990).

Job training programs are expensive to run, requiring not only facilities but instructors and supervisory and administrative personnel. Therefore, those firms that can afford to accept trainees under the government's guidelines generally are major corporations. According to a 1990 survey by the Labor Ministry, barely 10 percent of the surveyed 2,718 firms hosted trainees from abroad. As might be expected, the majority of foreign trainees — 57 percent — were at companies employing over 5,000 people. Businesses with 1,000 to 4,999 employees trained 28 percent of the sample, but only 11.4 percent of the trainees were at companies with 300 to 999 employees and a mere 3.4 percent were at firms with less than 300 employees.

The number of foreign trainees in Japan grew by upwards of 2.5 times between 1986 and 1990; participants from the People's Republic of China and Taiwan doubled in 1990 alone (see Table 3). Foreign workers increasingly have sought instruction in job skills considered to be low technology. This expertise often is available only at small and midsized companies, but these are the

Table 3: **Number of Foreign Trainees Entering Japan for First Time by Country of Origin, 1986-90**

	1986	1987	1988	1989	1990
People's Republic of China	2,848	2,688	3,840	3,496	7,624
Thailand	950	2,428	4,708	4,502	5,075
South Korea	2,336	2,800	3,343	4,125	4,485
Malaysia	620	757	1,329	2,175	3,564
Philippines	968	1,207	2,464	3,974	3,460
Indonesia	1,114	1,310	1,378	1,748	2,891
Taiwan	497	375	444	539	1,239
Brazil	521	576	628	851	1,027
India	346	327	313	368	602
United States	328	356	396	416	450
Other Countries	3,860	4,257	4,589	7,295	7,149
Total	14,388	17,081	23,432	29,489	37,566

Source: Ministry of Justice

types of businesses that usually cannot afford to run training programs. Moreover, current regulations scale the number of trainees to the size of the host company. A company with fewer than 50 employees, for example, can accept only up to three trainees; a firm with 51 to 100 employees can take double that number. Proponents of a revamped program for foreign workers point out that, since demand is growing for training in jobs categorized as unskilled or low technology-related, public assistance most likely will be required to encourage the participation of small and midsized businesses.

In line with the December recommendation of the government advisory panel MOL has come up with a new training scheme for foreign workers that covers about 400 types of jobs. Program participants will spend their initial nine months receiving vocational instruction at one of Japan's 300-plus public training facilities, which currently are used to upgrade the job skills of Japanese workers, as well as at host companies. After this training participants who pass job qualification tests can stay in Japan to work in the corporate sector for up to 15 months but no longer. In principle, family members of the trainees will not be allowed to accompany them to Japan. Other features of the new training program include a mandate to host companies to sign up with a special insurance fund that will cover costs associated with accidents and general medical expenses. In addition, the current restriction on the number of trainees a company can have will be reviewed with an eye toward encouraging small- and medium-scale firms to take more trainees.

To facilitate vocational training for foreign workers, especially in small and midsized companies, the Japan International Training Cooperation Organization was established last October jointly by the Ministries of Justice, Foreign Affairs, Labor and International Trade and Industry and the business community. The organization provides assistance to both host companies and trainees, offering guidance and consultation on immigration and training programs plus issues related to personal and community concerns, such as housing, food, cultural differences, accident insurance coverage and medical care. JITCO also helps put trainees in touch with appropriate host companies.

Interest in smoothing the interaction between foreign workers and Japanese citizens is growing. For example, the police and immigration authorities are encouraging their workers to learn not only English but Spanish, Korean, Thai, Persian and other specific languages to avoid miscommunications with foreigners from Third World countries. In addition, the Ministry of Home Affairs this April will establish a foreign language and culture training center to educate local government officials in ways to improve public services for foreign residents. For its part the Ministry of Education is working with local governments to try to expand the number of Japanese language teachers so that more foreign students can attend classes at public schools. In addition, the Ministry of Health and Welfare expects to conduct a survey to determine what diseases are prevalent overseas so that it can improve immunization programs for both foreign residents in Japan and Japanese citizens.

Tokyo expects the new MOL job training scheme and the other initiatives will enable it to get more detailed information about foreign workers in Japan, particularly those doing unskilled work. The hope is that public monitoring eventually will stem the inflow of foreigners willing to work illegally in Japan. In this sense the Labor Ministry's program, which will become operational later this year, not only is a breakthrough for opening the Japanese labor market to legal foreign workers but a lever that enables the government to lower the incentives for hiring illegal foreign workers.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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JEI

REPORT

A Two-Part Report: A and B

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Japan's Current Account Surplus Soared In 1991

Japan's 1991 current account statistics demonstrate that a rising surplus in total trade in goods and services is nothing to cheer about. Part of the reason is political. The apparently slow pace of the contraction in the Japanese surplus in the late 1980s was a sore point in Washington-Tokyo relations; the doubling of the imbalance to $72.6 billion in 1991, reversing three years of declines, is even worse from this standpoint (see Table 1). In the fourth quarter alone Japan's current account surplus jumped to $24.1 billion, the highest quarterly level since 1986 and nearly triple the comparable 1990 figure of $8.1 billion. As such, the latest figures are likely to exacerbate already tense relations between the two economic superpowers. A geographic breakdown is not yet available, but if, as is likely, the pattern follows that of the customs-clearance trade figures released earlier (see *JEI Report* No. 5B, February 7, 1992), Washington's displeasure may be nothing next to that of Europe and Asia, which registered larger increases in their bilateral trade deficits with Japan than did the United States.

Tokyo has reason to worry about the latest figures for economic reasons as well. The pattern of capital flows during 1991 suggests that Japanese financial institutions lacked confidence in the health of both their economy and that of Japan's trading partners. The data indicate that Japanese participants in international markets retreated to the sidelines last year, letting others take the initiative (see Table 2). For example, direct investment abroad dropped more than a third from 1990's level. This confirms indirect evidence that, while Japanese companies continued in 1991 to add to their stock of foreign factories, real estate and other overseas assets over which they have direct control, they did so far more slowly than in the late 1980s, although the figures do not suggest that the cumulative stock of real foreign assets was being reduced.

Somewhat the same situation existed with portfolio investment, where individual Japanese investors are assumed to play a more passive role than with direct investment if only because their world share relative to other investors is much smaller. In 1991 Japanese overseas investors increased their holdings of stocks and bonds by a larger amount than in 1990, but they easily were outspent by

Table 1: **Japan's Balance of Payments**

(in millions of dollars, IMF value basis)

	1987	1988	1989	1990	1991*
Current Account	$87,015	$79,631	$57,157	$35,761	$72,598
Trade Balance	96,386	95,012	76,917	63,528	103,289
Exports (f.o.b.)	224,605	259,765	269,570	280,374	306,597
Imports (f.o.b.)	128,219	164,753	192,653	216,846	203,308
Services	-5,702	-11,263	-15,526	-22,292	-18,220
Transfers	-3,669	-4,118	-4,234	-5,475	-12,471
Long-Term Capital	-136,532	-130,930	-89,246	-43,586	36,628
Basic Balance	-49,517	-51,299	-32,089	-7,825	109,226
Short-Term Capital	23,865	19,521	20,811	21,468	-26,352
Errors and Omissions	-3,893	2,796	-22,008	-20,877	-6,505
Overall Balance	-29,545	-28,982	-33,286	-7,234	76,369

*Preliminary.

Source: Bank of Japan

Table 2: **Net Long-Term Capital Flows**

(in millions of dollars)

	1990			1991*		
	Outflows	Inflows	Net	Outflows	Inflows	Net
Direct Investment	$-48,024	$1,753	$-46,271	$-31,167	$1,368	$-29,799
Trade Credits	681	-10	671	4,380	-3	4,377
Loans	-22,182	39,112	16,930	-13,538	38,126	24,588
Securities	-39,681	34,653	-5,028	-74,306	115,284	40,978
Stocks	-6,256	-13,276	-19,532	-3,630	46,833	43,203
Bonds	-28,961	16,991	-11,970	-68,202	21,236	-46,966
Yen-Denominated Bonds Issued in Japan	-4,464	n.a.	-4,464	-2,474	n.a.	-2,474
External Bonds**	n.a.	30,938	30,938	n.a.	47,215	47,215
Other	-11,560	1,672	-9,888	-7,245	3,729	-3,516
Total	-120,766	77,180	-43,586	-121,876	158,504	36,628

Note: A negative sign indicates a capital outflow.

*Preliminary.
**Bonds issued outside of Japan by Japanese institutions.

Source: Bank of Japan

foreigners snapping up substantial numbers of Japanese bonds as well as $46.8 billion of what they hoped would turn out to be bargains in the depressed Japanese stock markets. As a result, Japan's net portfolio position declined.

The net effect of the trends in Japanese direct investment, portfolio investment and other capital flows last year was a net long-term capital inflow of $36.6 billion, the first since 1980. While a short-term outflow of $26.4 billion largely offset this amount, Japan still was left with a positive net inflow combined with a larger current account surplus, a development apparently inconsistent with double-entry bookkeeping principles and one certain to give good accountants bad headaches. Normally, net capital outflows are the means by which Japan's trading partners finance their trade deficits with that country; as Table 1 shows, long-term capital outflows in the late 1980s tended to move in tandem with the current account surplus. Logically, then, the outflow should increase — not decrease, let alone reverse to become an inflow — when the surplus expands. Yet exactly this apparently incongruous result occurred in 1991.

This aberration is reflected in the bottom line of Table 1 in the record-high figure for the overall balance. Any number — positive or negative — for the overall balance would seem impossible given the rules of accounting. On examination, however, the overall balance turns out to be something other than the bottom line. The apparent discrepancy between movements in the current account and the capital account is explained by changes in Japan's foreign exchange reserves and in the net liabilities of authorized foreign exchange banks. These two remaining sources fill the gap between the current account and the long- and short-term capital flows described in Table 1.

Foreign exchange movements, however, were not the explanation in this case. Last year Japan's foreign exchange reserves fell by $8.1 billion, suggesting that foreign governments were not borrowing from Tokyo to counterbalance their countries' trade shortfalls. The explanation thus reverts to authorized foreign exchange banks. In 1991 these banks, which had become large net borrowers on international markets in recent years, reduced their international liabilities by a whopping $91.7 billion, resulting in a 36 percent reduction in the banks' outstanding debt in just 12 months. This single item alone was enough to finance the larger current account surplus, the increased capital inflows into Japan and the drop in foreign exchange reserves.

Of course, reducing liabilities is formally equivalent to increasing assets as a means of financing the worldwide capital shortage that some Japanese have argued is an appropriate international role for Japan. However, the fact that authorized foreign exchange banks, including the 11 Japanese nationwide commercial banks, began paying off their overseas borrowing could suggest that they saw few profitable opportunities abroad. In any case, the phenomenon implies a less aggressive stance for Japanese banks overseas. This approach hardly seems an indication of economic strength, but it is consistent with institutional pessimism in Japan concerning the country's own stock market and relatively sluggish overseas direct investment. Regardless of the perspective — from abroad or from Japan itself — the 1991 current account figures and the investment behavior that generated them surely are no reasons to activate a cheering section.

Douglas Ostrom

Japan Tries To Break Bears' Grip On Stock Market

The Tokyo Stock Exchange remains tightly gripped by bearish investors concerned over Japan's mixed economic news. The TSE's inability to shake off pessimism contrasts sharply with the New York Stock Exchange's ebullient mood, which has pushed market indexes to record levels. Japanese industry and government officials are both vexed and worried by the TSE's slump. The market's doldrums prevent companies from raising equity capital, thus restraining investment by nonfinancial firms and lending by banks. They also cut the value of Japanese banks' stock portfolios, which makes banks even less able to extend new loans. Moreover, the slump damages consumer confidence, contributing to the erosion of the largest component of domestic economic activity — consumer spending. At the same time, the stock market's lukewarm reaction to traditional support measures reveals the impact of financial deregulation and the limits on the ability of the government and other agents to influence the market.

After dropping nearly to the 20,000 mark — a critical level for bank stock portfolios — in the first half of January, the Nikkei average of 225 selected issues struggled back to the 21,000 range in the latter part of the month, due mainly to efforts by the Bank of Japan to lower short-term interest rates (see *JEI Report* No. 2B, January 17, 1992). Volume, however, remained very light, rarely topping 150 million shares traded daily.

In such a thin market the impact of arbitrage trading between the spot market, where actual shares are traded, and the derivative market, where stock futures and options contracts are bartered, can be decisive. To address these concerns the governing board of the Osaka Securities Exchange, Japan's second-largest market, announced January 23 that it was initiating a review of the rules governing stock index futures traded on the OSE. Based on the Nikkei 225 average, the OSE futures contract is the primary futures instrument in Japan. Initiated in mid-1989, the OSE futures market has been accused of disrupting the underlying TSE spot market every three months when futures contracts are settled. OSE President Hiroshi Yamanouchi said the board was reviewing the disclosure of futures trading information, the method of fixing settlement prices, the impact of current futures trading hours and the trading of futures by brokers for their own accounts. Brokers welcomed the OSE's rule review, generating some positive sentiment and helping to push the Nikkei above 22,000 January 31. But the momentum was short-lived. The TSE drifted lower until February 6 when it again rose above 22,000; that rise came in response to the OSE's announcement the previous day that its review had led to some changes expected to reduce the influence of futures trading on the spot market.

The ruling Liberal Democratic Party also is engaged in talking up the market. LDP secretary general Tamisuke Watanabe's suggestion January 31 that the LDP should investigate measures to prop up the market helped to ignite a 465-point rally that day. The efficacy of this type of jawboning clearly has limits, however. LDP Vice President Shin Kanemaru on February 13 called for a 0.5 percentage point cut in the 4.5 percent discount rate to boost the economy. Rather than responding positively, investors stayed on the sidelines that day; in fact, sell orders overwhelmed purchases, and the Nikkei lost 150 points.

The LDP's February 14 release of more concrete suggestions to support the market also failed to generate an immediate positive response. The ruling party's proposed steps included a reduction in the securities transaction tax (currently either 0.12 percent or 0.3 percent of the sales price, depending on the type of securities bought or sold), rule changes to allow pension and trust fund managers to put a greater portion of their portfolios into stocks, incentives for companies to raise dividend rates and revocation of the ban on firms trading their own stocks. While the LDP study group releasing the package said a discount rate cut would help, it avoided a direct call for such a move. Analysts said the measures might help the market in the medium term but would have little immediate effect. Investors apparently agreed; the TSE dropped more than 507 points February 14 to close below 21,000 (see Graph).

Japan's top four brokerage firms — Nomura Securities Co., Ltd., Daiwa Securities Co., Ltd., Nikko Securities Co., Ltd. and Yamaichi Securities Co., Ltd. — already had met earlier this year to discuss market support measures; reports of these talks had little impact on investor confidence. Trying again, the Big Four issued a call February 13 for the Ministry of Finance to ease two of its guidelines. The first, imposed in 1989 to limit the oligopolistic influence of the Big Four, prevents any broker from handling more than 30 percent of any single stock's monthly trading volume. The second, imposed in 1990 to calm market volatility, prevents securities firms from trading for their own accounts during the last 15 minutes of both the morning and the afternoon trading sessions. Judging from the TSE's downward drift of February 13 and 14, the market was unimpressed with these ideas.

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JEI REPORT

A Two-Part Report: A and B

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GATT Talks Race The Calendar

When the Reagan administration plotted strategy in 1986 for the impending round of multilateral trade talks that would become known as the Uruguay Round, few officials could have anticipated that the talks would spill over into either the second term of Mr. Reagan's successor or the first term of a third president. However, with the presidential primary season already underway, officials from the United States, the European Community and Japan are beginning to hint at just such a possibility.

The talks, which began in September 1986, were supposed to end four years later. Even though the scheduled 1990 windup in Brussels ended in discord (see *JEI Report* No. 48B, December 21, 1990), as recently as last fall few observers thought that the process could extend into 1993. At that time the director general of the General Agreement on Tariffs and Trade, under whose auspices the negotiations are being held, issued what appeared to be an ultimatum to the negotiating parties: reach an agreement or have one imposed by November (see *JEI Report* No. 37B, October 4, 1991). Like so many other Uruguay Round deadlines, the November date came and went without action from either side.

On December 20, however, the director general, Arthur Dunkel, presented his outline of an agreement. The reaction to the Dunkel draft from nearly all affected parties was lukewarm at best. The Bush adminstration proved somewhat of an exception; although publicly noncommittal, officials

Negotiators in the current round of talks face yet another deadline, April 15, which Mr. Dunkel has suggested as a date for signing a final document. Increasing numbers of participants see that deadline slipping. A main sticking point — as it has been since the beginning of the Uruguay Round — is agriculture, with the European Community apparently still obdurate about reducing agricultural export subsidies, internal supports and import barriers even to the extent envisaged in the Dunkel text, which calls for less than Washington had wanted. In addition, Tokyo, while supporting many of the agricultural proposals, remains publicly opposed to tariffication, which Brussels generally supports.

The apparent lack of recent progress has led to renewed calls for the personal involvement of top European and American political leaders in the talks. The fear expressed recently by German Economics Minister Jurgen Mollemann and others is that the Uruguay Round could collapse completely if an agreement is not reached within the next few months.

Even if the GATT participants defy the history of the Uruguay Round and somehow meet the April deadline, further calendar-related problems loom. Under existing law Congress is supposed to be notified 90 days prior to its consideration of any agreement. Although fast-track procedures prevent Capitol Hill from amending any GATT accord submitted by the White House, legislators would be able to use the 90-day period, in part, to negotiate with the White House concerning the extent to which existing U.S. laws would require modification. Hence, an agreement in April implies a vote in July at the earliest. With Congress breaking for the political conventions this summer and likely to face a crowded economic agenda in any case, legislators would have little time to consider any GATT accord. Nor does the fall shape up as a very promising time to debate an agreement; Congress typically adjourns well before the November presidential election. Finally, given the high level of partisanship and strong feelings about trade, the path through Congress for a new GATT agreement might well be acrimonious and prolonged. For these reasons the Uruguay Round process, assuming it does not break down completely, may well span three U.S. presidential terms. Depending on Mr. Bush's fate in November, it could involve an equal number of presidents.

Douglas Ostrom

Japanese Worked Up Over Working Hours

While the Japanese justifiably can be proud of their country's status as an economic superpower, few would deny that the price of this achievement has been high in some respects. Japan's reputation as a nation of workaholics increasingly is seen as one of those high costs, and the domestic chorus for change is growing. The government, labor unions, consumers and, most recently, industry advocate cutting average annual working hours to improve the quality of workers' lives, to spur personal spending and to improve labor productivity. Despite this near unanimity of opinion, it is generally agreed that there is little chance of attaining the government's goal of 1,800 average annual work hours by April 1, 1993.

Widespread expectations in the 1970s that prosperity would lead to fewer working hours were fulfilled as the average number of regularly scheduled hours dropped from 2,039 in 1970 to 1,937 by the middle of the decade; average overtime fell from 200 hours to 127 over the same period (see Table 1). By the end of the 1970s, however, workers gave up about one-third of these gains as the economy went through several difficult adjustments. While the average number of regularly scheduled hours drifted lower in the 1980s, rising overtime negated most of the gain. Comparing the years 1980 and 1989 total working hours dropped only 20 hours.

Taking more of an interest in this issue, Tokyo first suggested in 1986 that a cutback in working hours be a higher priority for both government and industry. Besides the obvious step of cutting regularly scheduled hours the Ministries of Labor and International Trade and Industry subsequently recommended several other methods to decrease time on the job, including increasing

Table 1: **Working Hours in Japan, 1970-91***

(average hours per year)

Year	Total	Scheduled	Overtime
1970	2,239	2,039	200
1975	2,064	1,937	127
1980	2,108	1,946	162
1981	2,101	1,940	161
1982	2,096	1,939	157
1983	2,098	1,937	161
1984	2,116	1,945	171
1985	2,110	1,932	178
1986	2,102	1,930	172
1987	2,111	1,933	178
1988	2,111	1,922	189
1989	2,088	1,898	190
1990	2,052	1,866	186
1991**	2,022	1,847	175

*Based on Ministry of Labor survey of companies with 30 or more regular workers. Part-time workers are excluded from the survey, as are agricultural and forestry workers and public-sector employees.
**Preliminary.

Source: Ministry of Labor

the number of paid holidays, expanding paid vacation days (and encourging workers to take them) and limiting overtime (see *JEI Report* No. 11A, March 16, 1990, and No. 23B, June 15, 1990).

The latest Labor Ministry data show that working hours have fallen steadily in the past three years, thanks to declines in both regular and overtime hours. The drop in scheduled hours, however, has been greater than that in overtime, a particularly welcome development since regular hours, being less dependent on the state of the economy, are a more basic indicator of time on the job.

The sectoral distribution of total working hours remained skewed along traditional lines, according to preliminary Labor Ministry data for 1991. The construction, transport and communications sectors, tied at 2,162 hours, topped the ranking, followed by mining (2,148) and manufacturing (2,080). Workers in finance and insurance (1,796) put in the fewest hours in 1991, followed by distribution, retail and food service workers (1,890), other services (1,954), real estate (1,973) and utilities (1,987). Among manufacturing workers, those involved in lumber and wood products continued to log the most hours (2,210 in 1991). This, however, was only 16 hours a month more than the national average; throughout the 1980s the gap had averaged about 20 hours. Workers making transport equipment put in the next highest average (2,173), followed by makers of nonelectric machinery (2,155), manufactured metal products (2,153) and nonferrous metals (2,146). Only employees in the chemicals (1,942), petroleum and coal (1,994), food (2,002) and apparel (2,020) industries put in fewer hours than the 2,022 average.

Data comparing Japan with other advanced industrialized nations, although not as recent, show a gap of about 520 hours, at most, in the manufacturing area (see Table 2). While the financial and public sectors gradually are phasing in a five-day workweek, most Japanese manufacturers still operate on Saturdays, keeping the gap in nonwork weekend days at 19. Japanese workers still enjoy more national holidays than their foreign peers but take less paid leave and fewer days off because of sickness or other reasons.

Table 2: **International Comparison of Manufacturing Working Hours, 1989**

(in days except for total hours worked)

	Total Hours Worked	Nonwork Weekends	National Holidays	Paid Leave	Other Absence
Japan	2,159	85	20	9	3
United Kingdom	1,989	104	8	24	11
United States	1,957	104	9	19	6
France	1,646	104	8	26	16
West Germany	1,638	104	11	29	11

Source: Ministry of Labor

Japan's poor showing in this international comparison has heightened the average Japanese citizen's awareness that his or her standard of living is not commensurate with the nation's overall economic prowess. Several recent Japanese court cases against employers alleging sudden death due to overwork (called *karoshi* in Japan) have spotlighted growing popular concern with the issue. Jousting over lower working hours also is a major facet of this year's annual wage negotiations (see *JEI Report* No. 6B, February 14, 1992). It likely will remain so for many years given the historical pace of change.

Jon Choy

LDP Explores Possible Compromises On Peacekeeping Bill

Japanese newspaper headlines might lead one to believe that every waking minute of the day Prime Minister Kiichi Miyazawa and senior Liberal Democratic Party officials are engaged in damage control due to the brouhaha over suspected corrupt behavior within the LDP. Although exaggerated, the emphasis underscores the widespread ruling party anxiety. For several weeks the opposition parties have tied up Diet action on the FY 1992 budget and other legislation by hinging participation in hearings to their demands that LDP witnesses be brought before the parliament to testify on various charges of unethical and perhaps illegal behavior. Among the cases opposition members want to examine are the arrest on bribery charges of Fumio Abe, one of Mr. Miyazawa's close associates, as well as the prime minister's relationship with Recruit Co., Ltd. during the mid- and late 1980s (see *JEI Report* No. 7B, February 21, 1992).

The paralysis in the legislature is likely to end soon, since the ruling party has acquiesced to summon as sworn witnesses some of the LDP politicians singled out for questioning by the political opposition. In addition, the opposition parties have agreed among themselves not to hold the budget hostage to the corruption issue too much longer. (Both houses must pass the budget by April 1 for it to become effective by that date, the start of Japan's fiscal year. Passage by the lower house alone would allow the budget to go into effect after 30 days.) The opposition apparently is concerned that these stall tactics may disrupt the business climate and, in turn, make the parties appear irresponsible in the eyes of Japanese voters, who will go to the polls in July to select upper house representatives.

While the ruling and the opposition parties have fought over how to handle allegations of politicians' illegal and/or unethical conduct, the wheels of the policymaking process have continued to roll. Senior LDP politicians and government officials have proceeded with behind-the-scenes discussions with certain members of the political opposition in an effort to craft legislative compromises that can pass the Diet soon after the Abe bribery-related stalemate is broken and the next fiscal year's budget is passed.

Proposal Unveiled To Boost U.S. Automakers' Competitiveness

The chairman of the Senate Finance Committee's subcommittee on international trade announced a plan February 21 intended to give U.S. automotive manufacturers some relief from Japanese competition while the American industry takes steps to improve its competitiveness. In a speech to the Center for National Policy, a Washington, D.C.-based research organization, Sen. Max Baucus (D, Mont.) characterized his proposal as offering "short-term import relief in return for a commitment to build a more competitive industry and produce better products." Although the Montana Democrat presents his proposal as a more viable alternative to other congressional initiatives aimed at addressing the problems of the U.S. automotive industry, observers question how much support the measure can garner from both Washington and Detroit. Yet in light of Detroit's record losses in 1991 and General Motors Corp.'s December announcement that 74,000 jobs would be eliminated in the next few years, business and government leaders are certain to be searching for ways to help the Big Three U.S. motor vehicle makers compete.

In his speech Sen. Baucus indicated that he is open to further discussion of the specifics of his proposal, which he reportedly intends to introduce by mid-March. As outlined, the plan calls on Washington and Tokyo to negotiate a standstill agreement that would limit the sale of imported and domestically made Japanese cars and light vehicles to 1991 levels, which Mr. Baucus calculated as about 3.6 million units, comprising approximately 1.6 million produced here and 2 million imported from Japan (see Table). The proposal calls for Washington to impose tariffs on imported vehicles if a voluntary restraint arrangement cannot be negotiated. Vehicles with more than 70 percent North American content would be considered domestic and therefore would be excluded from the limit. Currently Japanese automotive manufacturers are operating under a VRA that keeps imports below 2.3 million units, a level that has been retained by the Japanese since it was negotiated for FY 1986 (see *JEI Report* No. 5B, February 7, 1992).

In exchange for protection U.S. automotive manufacturers would have to demonstrate improvements in: the quality of their product, production efficiency and customer service. The standards used to measure these objectives would be those established by the Department of Commerce for the Malcolm Baldrige National Quality Award. The proposal also calls for executive compensation in the motor vehicle industry to be brought into line with the international norm.

To ensure that the industry is keeping up its side of the bargain the International Trade Commission, in consultation with the White House and Congress, would review the VRA every two years. The measure would give the ITC authority to recommend three courses of action: elimination of the restraint arrangement if the American industry is not making progress as measured by the quality criteria; adjustment of the quota level in response to shifts in American demand (the effect on consumers would be a factor in revising the limits); and an increase in the shipment ceiling on a one-to-one basis if American car and light truck exports to Japan rise. Recommendations made by the ITC would take effect automatically unless vetoed by a joint congressional resolution; the president, in turn, could veto the joint resolution.

Sen. Baucus suggested that the program not extend beyond seven years. He noted that one goal of the measure is to have an American automotive industry that is fully competitive internationally within this period. His proposal would encourage the Big Three to continue investing in American production facilities and in worker training programs. The plan also would promote joint research and development, the Montana Democrat said.

Sen. Baucus often has fought against alleged Japanese barriers to trade, but he is considered an advocate of free trade and has sought domestic answers to this country's competitiveness problems. In unveiling this proposal he asserted that the U.S. government needs to "find a better way to do its job" of helping American industry compete and asked rhetorically why Washington cannot do this "in a way that encourages [the industry] to become more competitive, instead of falling further behind."

U.S. Retail Sales of Japanese Cars and Light Trucks, 1991

(in units)

Cars	
Imported/Japanese-Badged	1,347,446
Imported/Big Three-Badged	156,592
Total	1,504,038
Domestic/Japanese-Badged	1,124,401
Domestic/Big Three-Badged	241,062
Total	1,365,463
Imported and Domestic/Japanese-Badged	2,471,847
Imported and Domestic/Big Three-Badged	397,654
Total	2,869,501
Light Trucks	
Imported/Japanese-Badged	491,085
Imported/Big Three-Badged	4,671
Total	495,756
Domestic/Japanese-Badged	201,839
Domestic/Big Three-Badged	30,702
Total	232,541
Imported and Domestic/Japanese-Badged	692,924
Imported and Domestic/Big Three-Badged	35,373
Total	728,297
Cars and Light Trucks	
Imported and Domestic/Japanese-Badged	3,164,771
Imported and Domestic/Big Three-Badged	433,027
Total	3,597,798
Of which:	
Imported	1,999,794
Domestic	1,598,004

Source: *Automotive News*

Some industry requests for protection "will be politically impossible to resist," Sen. Baucus said, adding that budget constraints make conditioned import relief "one of the few tools the U.S. government can use to promote competitiveness." Because an industry's request for protection entails costs for American consumers, Sen. Baucus asserted that this country "has the right to demand a return on its investment."

The Montana Democrat claims that the conditions imposed by his plan move the current restrictions on Japan's U.S.-bound car shipments beyond being of benefit only to U.S. automotive manufacturers and their shareholders and result in incentives for new investments in the industry. During much of the 1980s, he said during his speech, Detroit "squandered the relief" provided by Tokyo's restraints on car exports to this country.

Sen. Baucus has framed his proposal as an alternative to the Trade Enhancement Act of 1992. That measure, introduced in late January in their respective chambers by House Majority Leader

Richard Gephardt (D, Mo.) and Sen. Donald Riegle (D, Mich.), would require the administration to limit U.S. sales of domestically made and imported Japanese cars and light trucks to 1991 levels if Japan does not reduce its trade imbalance with the United States by 20 percent a year for the next five years (see *JEI Report* No. 2B, January 17, 1992). The automotive industry has shown more enthusiasm for the Gephardt-Riegle proposal than for the Baucus measure. Fear of micromanagement of the industry is said to be one concern. Observers also note that Sen. Baucus' suggestions regarding executive salaries and quality review by Washington are hardly likely to be welcomed in Detroit. A spokesperson for General Motors indicated that the company would rather address trade issues in "ongoing negotiations at the government and industry levels."

Although Sen. Baucus contends that stricter limits on Japanese automotive producers are "likely, given the political currents, Americans worried about jobs, [and the] election year," others on Capitol Hill are less confident that Congress will pass such legislation this year. Congressional observers note that Sen. Baucus' measure would be certain to run into resistance in the House. Reps. Dan Rostenkowski (D, Ill.) and Sam Gibbons (D, Fla.), the chairmen, respectively, of the Committee on Ways and Means and its subcommittee on trade, are considered opponents of restraint arrangements. A number of Washington watchers have said that the chance of Congress passing such restrictive legislation this session hinges on the extent to which Japan follows through on the pledges announced during President Bush's January trip to Tokyo to increase purchases of cars and automotive parts (see *JEI Report* No. 2B, January 17, 1992).

Some on Capitol Hill have suggested giving the U.S. economy and the American automotive industry a boost by increasing the tariffs on certain sports-utility vehicles. Additionally, several lawmakers have attempted in recent weeks to tackle the question of what makes a car or truck domestic by introducing legislation requiring automotive manufacturers to identify where each vehicle is assembled as well as the percentage of North American parts and labor incorporated in the product. An aide to the sponsor of one such bill noted that in view of the ongoing Buy American debate in this country, consumers need to be better educated about product origins. One problem is that the United States and Canada do not agree on what constitutes North American content, further complicating Washington's unilateral adoption of a definition. Sen. Baucus reportedly has not settled on a means of calculating the 70 percent domestic content threshold described in his proposal.

The Japanese government was quick to characterize Sen. Baucus' plan as "managed trade," which would violate both multilateral trade rules and bilateral agreements. For its part the Bush administration has warned that it will veto any protectionist legislation. The White House is expected to oppose the Baucus measure. Aides to Sen. Baucus say that they do not foresee any immediate trade subcommittee hearings on the proposal.

Margo Grimm

Notes

Japan-U.S. Business Council - A change of scene from the usual Hawaii venue for the board of directors meeting of the Tokyo-based Japan-U.S. Business Council and the Washington, D.C.-based U.S.-Japan Business Council reflected a heightened sensitivity to bilateral relations. Held in Washington February 16-18, the meeting brought together 32 top Japanese and American business executives. In agreeing to continue to work together to reduce the bilateral trade imbalance, the businessmen urged Tokyo to "initiate an import vision" and Washington to "initiate an export vision, with special emphasis on Japan." The call for both governments to make trade a national priority raised questions among some participants about whether the recommendation amounted to a call for managed trade. Although the corporate leaders did not specify what was meant by the import or export visions, the press release from the board meeting suggested that the private sectors in Japan and the United States expected more government involvement in bilateral economic relations.

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JAPAN'S MULTINATIONAL CORPORATIONS AT A TURNING POINT

SUMMARY

As Japan's involvement in the international economy has grown, its companies continuously have altered their mode of operation. Among other changes firms have established a presence on the ground in an array of countries that are bewilderingly different from Japan. The exponential growth in the 1980s of Japanese direct investment abroad raises questions about the internationalization of the corporate culture.

Japan's corporate foreign direct investment to date arguably has had a different relation to both the host and the home nation than that of other nations' companies. In general, the head office has exercised tighter control. While the mass media in the United States generally give the impression that the operations of Japanese-affiliated companies in this country have been smashing successes from the firms' — if not society's — viewpoint, such conclusions appear to be premature. The jury still is out as to whether Japanese firms can overcome the inherent disadvantages of multinational companies and be as successful as their counterparts in other industrial countries.

The Road to Internationalization

Many analysts divide the process of corporate internationalization into phases. In the first phase firms begin overseas sales of the products they produce at home. In this stage, which may involve exports and imports exclusively, manufacturers are forced to pay attention to the world beyond their boundaries for the first time. Only later do the firms venture offshore to build facilities that supply foreign markets from abroad; in this way they replace exports, at least to the degree that exports otherwise would reach higher levels. Usually at this stage — and not earlier — companies are regarded as multinationals. In the final stage the overseas facility even may be a significant source of imports for the home country as well as a major supplier of the local market.

In this simple description the establishment of an export market becomes a prerequisite for direct investment abroad. Firms generally need the assurance that their product will sell abroad before they commit themselves to a substantial investment in overseas facilities. An important exception are service industries. In such sectors as banking and lodging exports are virtually impossible. If Mitsubishi Bank, Ltd., for example, wants to sell its services to Americans or to expatriate Japanese here, it cannot avoid setting up shop on this side of the ocean.

Exporters, however, do not necessarily become multinational firms.[1] In fact, becoming a multinational would appear as unlikely as the ungainly bumble bee learning to fly; theoretically both acts appear to be impossible. To the extent that a company is good at something, its greatest advantage is likely to be on its home turf, where language and customs are most familiar. Success may depend on an advantage (low-cost or highly skilled labor) that is available only at home. This factor suggests that exports are the more logical course. Conversely, if a foreign location is an imperative, as in banking, local firms typically have an advantage over the would-be foreign investor. The foreign firm well may find that its advantage is location-specific so that it will have disadvantages — rather than advantages — compared to local firms should it establish operations abroad. Even if its advantage can be exploited equally everywhere, in some cases the foreign firm may find it more profitable to make that advantage available — for a franchise or licensing fee — to local firms that do not have the burden of unfamiliar language, culture and operating conditions. If for some reason such expertise or cost advantage is not marketable through such agreements, the would-be investor faces a worry that potential rivals could obtain the same advantage. If impressed early on that maintaining an edge over local companies would be futile, a wise firm logically would decide against the investment.

In short, experts can give would-be foreign investors and bumble bees many reasons why they should be cautious about spreading their wings. But bumble bees fly, and firms invest abroad. In both cases they have advantages that defy conventional wisdom. Firms invest abroad because exports may be impossible or difficult for economic or political reasons and they find that they have some pluses that overcome the minuses of an inherently alien environment.

Growth of Japanese Foreign Direct Investment

For much of the postwar era Japanese firms did not feel as if they could overcome the inherent disadvantages of overseas investment. In addition, until at least the 1960s, they faced government-imposed restrictions on their ability to invest overseas.[2] If they were good at producing something (cameras and consumer electronics products, for example), the product entered international commerce as an export. Whenever Japanese suppliers did not have a comparative advantage or Japan appeared an unlikely or undesirable place in which to produce a product, imports typically filled the bill (wheat and crude oil, to name two), with domestic firms — other than the trading companies that facilitated imports and exports — having little involvement outside Japan. (However, of what little direct investment abroad did occur during this period more than a third was natural resource-based.) If the product or service could be produced or provided only on location, the Japanese presence abroad was minimal (banking, insurance, retailing).

By the early 1980s, if not earlier, this cozy division of labor began changing. As trade tensions increased in Japan's export markets, Japanese firms faced the prospect of losing market share if they did not establish a means of surmounting rising protectionist barriers, such as the 1981 voluntary restraint agreement on Japan's U.S.-bound car exports. In addition, some Japanese analysts have argued that the changing composition of Japanese foreign sales dictated a presence closer to the final consumer, even when protectionist pressures were absent.

Different factors motivated investment in the service sector. Rising levels of Japanese exports and of Japanese tourists abroad created new demands for service industries, such as Japanese-owned

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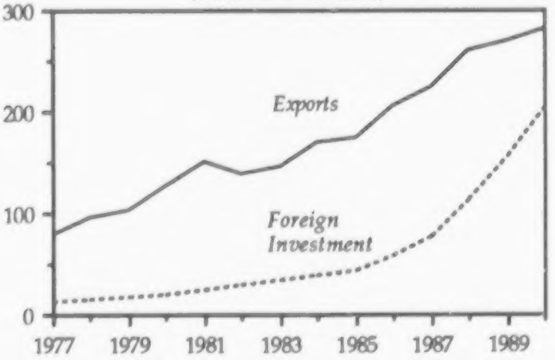
financial institutions and lodging companies. These were perceived rightly or wrongly as having advantages that local companies could not provide for Japanese clients. Hence, Nomura Securities Co., Ltd. and Nikko Hotels followed in the footsteps of Merrill Lynch & Co. and Hilton Hotels in establishing a worldwide presence. Finally, some financial institutions may have had new incentives to go abroad, either to avoid restrictions on their activity in Japan or to try out new services they hoped to introduce in Japan once restrictions were lifted. (For this argument with respect to banks, see *JEI Report* No. 22A, June 8, 1990; for a similar argument concerning insurance companies, see *JEI Report* No. 31A, August 12, 1988.)

At the same time that the benefits of foreign investment were increasing, the costs were declining. As the yen increased in value after 1985 the cost advantage of producing in Japan dropped sharply or became a disadvantage — even compared to relatively high-cost manufacturing nations such as the United States. A stronger yen meant that any given dollar cost corresponded to a lower yen cost. Although dollar-denominated manufacturing costs in Japan had increased only slightly betweeen 1973 and 1985, they shot up more than 40 percent between 1985 and 1988 alone. By 1990 Japanese manufacturing costs on average were 10 percent above those of the United States despite a relatively weak yen that year.[3] By mid-February 1992 the yen had appreciated more than 10 percent from its 1990 average level, suggesting that the U.S. cost advantage may have widened despite higher inflation in this country. (For details of Japanese pricing decisions in the context of the higher yen, see *JEI Report* No. 43A, November 15, 1991.)

Figure 1 shows the growth of Japan's dollar-denominated exports and the stock of Japanese direct investment abroad. (Direct investment abroad is defined as loans, equity positions or business-related real estate transactions involving overseas branches, subsidiaries or associated companies in which the Japanese investor has at least 10 percent equity.) Foreign direct investment grew consistently faster than exports throughout the period, more than tripling between 1977 and 1984 against roughly a doubling of exports. Between 1984 and 1990 the gap in growth rates appeared to widen even more as the stock of direct investment abroad soared by 431.2 percent, while exports increased 66.1 percent. (In the latter period dollar depreciation substantially inflated both figures.) Given that manufacturing maintained a roughly equal share of the capital stock, plus the assumption that production increases roughly correspond to capacity increases, Figure 1 suggests that overseas production has become far more important relative to exports than just a few years ago. The numbers, however, do not provide guidance as to the relative current status of each means of supplying foreign markets.

Figure 1: **Japan's Exports and Stock of Direct Investment Abroad 1977-1990**

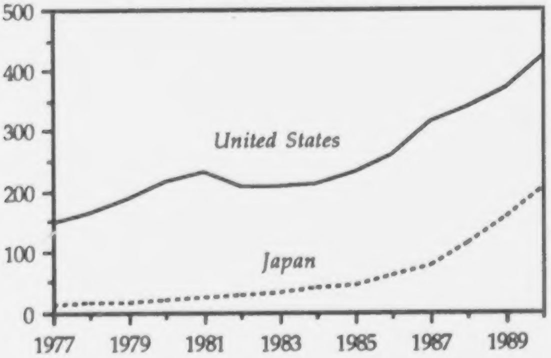
(billions of dollars)



Source: Bank of Japan

Figure 2 shows Japanese direct investment abroad relative to that of the United States. Despite the recent rapid growth in Japanese direct investment abroad, the U.S. level still was more than twice as high in 1990, the latest year for which complete data are available. Both figures are based on historical cost, or the cost of acquiring the overseas property, regardless of current value. Recent Department of Commerce estimates suggest that the market cost of U.S. direct investment abroad was twice historical cost in 1988. For this reason, the U.S. figure probably is understated relative to that of Japan since American investment is older on average. Based on estimates of the Japan External Trade Organization (in which the same deficiencies occur), U.S. direct investment abroad represented 29.6 percent of the world total in 1989, the most recent year for which comparable data are available. Runners-up Great Britain and Japan accounted for 15.2 percent and 12.2 percent, respectively.

Figure 2: **Stock of U.S. and Japanese Direct Investment Abroad**
(billions of dollars)



Source: Department of Commerce and Bank of Japan

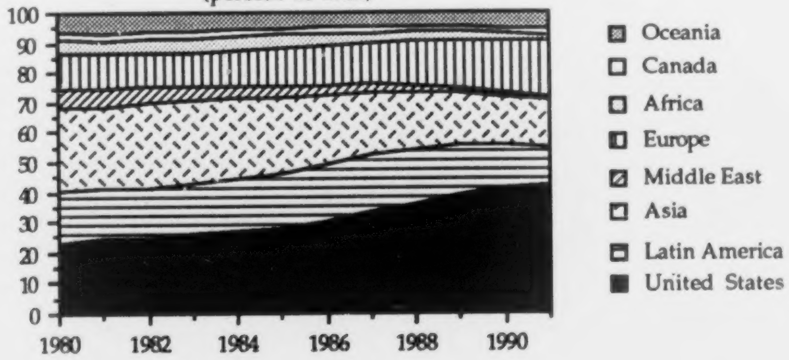
Figures 3 and 4 show how the distribution of Japanese direct investment abroad has changed over time. In contrast to Figures 1 and 2, which use Bank of Japan data, Figures 3 and 4 use Ministry of Finance data.[4] Since the 1970s the proportion of Japan's direct investment abroad going to the United States and Europe has risen substantially, while the proportion going to Asia and Latin America has fallen. For example, the United States represented 21 percent of the outstanding level of Japanese foreign direct investment on March 31, 1977; on the same date in 1987 this level had risen to 30.2 percent, and in 1991, the most recent year for which data are available, to 42 percent.

These figures argue against the proposition sometimes heard that Japanese firms increasingly have emphasized the development of an integrated economy within Asia at the expense of the United States. Japan's economy may be in the process of becoming more integrated with those abroad generally; if so, the process probably has proceeded further in North America than elsewhere. For example, in 1987 overall Japanese direct investment in this country was 18 times as large as that in Thailand. By 1991, despite the widely publicized growth in Japanese direct investment in that Asian country in the intervening years, the United States had 29.5 times as much Japanese direct investment as did Thailand.

The pattern by industry shows that nonmanufacturing industries typically have garnered slightly more than 70 percent of all direct investment flows, reaching 71.8 percent of the total stock as of March 31, 1991. Even within manufacturing variation has been comparatively modest. In FY 1981 the transportation equipment industry accounted for 2.7 percent of total outstanding direct investment

Figure 3: **Geographic Distribution of Japanese Direct Investment Abroad, FY 1979—FY 1990**

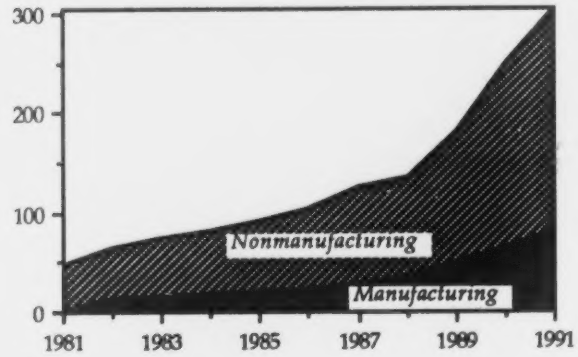
(percent of total)



Note: Data compiled March 31 of each year.
Source: Ministry of Finance

Figure 4: **Stock of Direct Investment Abroad by Industry, FY 1980—FY 1990**

(billions of dollars)



Note: March 31 of each year.
Source: Ministry of Finance

abroad, rising to 4 percent in FY 1986 and dropping to 3.5 percent in FY 1991. Obviously, in some subcategories in particular host nations, the variation has been greater. In 1980 no Japanese-affiliated automotive assembly plants existed in the United States; such plants employed thousands of workers by 1991.

Table 1 shows the distribution of Japanese direct investment in the United States by industry based on Department of Commerce data, which correspond more closely to BOJ than to MOF data in terms of aggregate totals. (Since the criteria for industry classification differ from that employed in Figure 3, comparisons between Figure 3 and Table 1 are inappropriate.) Table 1 points to a sharp rise in the share of outstanding Japanese investment accounted for by manufacturing during the second half of the 1980s. The share of wholesale trade, in contrast, declined over that time frame despite some manufacturing activity being classified as "wholesale trade" on the basis of the historical activity of firms that had begun manufacturing here.

Table 1: **Japan's Foreign Direct Investment Position in the United States, Yearend 1986-90**

(in millions of dollars, historical cost basis)

	1986	1987	1988	1989	1990
Total	$26,824	$34,421	$51,126	$67,319	$83,498
Petroleum	34	-56	-64	-35	-38
Manufacturing	3,578	4,970	11,065	13,978	15,169
Food Products	158	281	393	641	662
Chemicals	279	932	1,677	2,272	3,918
Metals	471	602	1,293	2,248	2,090
Machinery	1,052	1,686	2,930	4,150	4,210
Other	1,618	1,469	4,772	4,667	4,289
Wholesale Trade	13,687	15,927	18,462	21,972	27,645
Retail Trade	290	373	411	511	627
Banking	2,704	3,655	4,367	4,959	6,025
Finance	2,087	2,994	5,666	9,407	10,402
Insurance	*	188	266	355	477
Real Estate	2,941	4,386	8,190	11,370	15,860
Other	1,306	1,984	2,763	4,802	7,331

*Suppressed to avoid disclosure of data on individual companies.

Source: Department of Commerce

Are Japanese Companies Becoming More International?

Kokusai-ka is a Japanese term that has been in use for generations. It means "internationalization" and has been used both descriptively and prescriptively to describe changes in Japanese individuals, corporations and government. Exactly what *kokusai-ka* means in specific instances often is elusive, however. Surely, Japanese companies are more "international" now than they were 20 years ago if one considers only the extent to which they are known overseas. As suggested above, they also increasingly have become employers abroad; this new role brings with it increased concern with laws and customs of other countries. Internationalization may be defined alternatively as the production of output abroad or as the use of foreign inputs. These two concepts lead to somewhat different conclusions as to how international Japanese companies have become.

Internationalization of Output - Table 2 shows that internationalization in the sense of firms producing a high share of their output overseas is an area where Japanese companies have come a long way but by no means have caught up with their American and German counterparts. Table 2 also suggests that Japanese direct investment abroad is more likely in industries in which Japan is most competitive, especially if one assumes that Japan is more competitive in products using skilled workers than those that do not. For example, among a cross section of manufacturers surveyed in 1989 by the Ministry of International Trade and Industry, 5.7 percent of combined manufacturing output occurred outside Japan, but at 15.9 percent the figure was far higher for makers of transportation equipment, such as cars, and for electrical machinery manufacturers at 11 percent than for makers of textiles (1.3 percent) or food products (1.3 percent).[5] In this respect, Japan is similar to the United States. A recent MITI study found that both the United States and Japan tended to have higher levels of direct investment abroad in those industries in which they were highly competitive than in those in which they were not.[6]

Table 2: **International Comparison of Overseas Production, 1979-90**

(manufacturing output at overseas affiliates as percentage of total production)

			Japan		
	United States	West Germany*	Total	Textiles	Transport Equipment
1979	19.5%**	9.2%	1.6%	n.a.	n.a.
1980	n.a.	10.1	2.9	4.0%	2.2%
1982	21.1	12.1	3.2	2.7	6.1
1984	18.1	14.2	4.3	4.7	6.4
1985	18.1	13.7	3.0	2.7	5.6
			(3.5)	(3.5)	(6.4)
1986	21.0	10.3	(3.2)	(3.4)	(4.8)
1987	21.0	n.a.	(4.0)	(3.1)	(9.3)
1988	24.9	n.a.	(4.9)	(4.2)	(9.4)
1989	n.a.	11.5	(5.7)	(1.3)	(15.9)
1990	n.a.	n.a.	(6.3)	n.a.	n.a.

*Excludes production in other European Community nations.
**1977 data.

Notes: The data for the United States and West Germany are on a calendar-year basis, while the figures for Japan are based on the fiscal year.
The figures in parenthesis include production by subsidiaries of subsidiaries.

Sources: Ministry of International Trade and Industry, "Kaigai Jigyo Katsudo Doko Chosa" (April 1989), and *Tsusho Hakusho* (Tokyo, Japan: Okura-sho, 1991), p. 212; Economic Planning Agency, *Kaizai Hakusho* (Tokyo, Japan: Okura-sho, 1991), p. 494.

In addition, investment seems most likely in those countries that are Japan's rivals in producing goods and services using high-wage labor. For example, Japanese direct investment has been especially large in North America in recent years. The MITI survey suggested that the main reason for such activity (cited by 60 percent of all respondents, who were able to give multiple responses) was to "expand sales in the world market" rather than cost-related reasons (cited by fewer than 30 percent). Even among those who had invested in the relatively low-wage countries belonging to the Association of Southeast Asian Nations, costs were cited in only 70 percent of all cases.[7] This suggests that Japanese firms' investment decisions are not necessarily motivated by low wages abroad; in some cases wages appear to be virtually irrelevant.

To the extent that Japanese direct investment abroad primarily is in response to protectionism or political pressure rather than cost considerations, the internationalization of Japanese companies probably is much less than it otherwise might be. As Gary Saxonhouse of the University of Michigan has argued in congressional testimony concerning foreign direct investment in the United States:

> ... Restraints on Japanese exports too often forces Japan to produce abroad what it could perfectly well produce at home. Therefore, it's hardly surprising that such Japanese-owned factories abroad import as many components as they possibly can from Japan. This is not the result of any cultural peculiarity. Rather these components are the basis of their competitiveness. It is a sensible economic response to a difficult situation created by foreign protectionism.[8]

Not surprisingly, relatively little of what Japanese companies make overseas finds its way back to Japan, according to MITI studies. In 1989 only 7.9 percent of the production of Japanese-owned manufacturing plants overseas was exported to Japan; instead, over 80 percent of the output was sold in the host nation. Asia was somwhat different in this regard; roughly 60 percent of the manufacturing output was sold in the nation in which it was produced, less than 20 percent shipped to Japan and about 20 percent sold in third markets.[9]

In contrast, Commerce Department figures show that 12.9 percent of the worldwide output of foreign manufacturing subsidiaries of U.S. parents was shipped to the United States in 1988. Roughly 60 percent was marketed in the host nation. Exports to the United States from Asian-based U.S. subsidiaries, however, were higher at 23.2 percent, while 43.4 percent remained in the country of production and 33.5 percent was sold elsewhere. Hence, while U.S. firms, like Japanese companies, sell large amounts of their output in the host nation, American companies are more likely than their Japanese counterparts to export from the host nation, either to this country or elsewhere.

In short, Japanese firms have further to go to obtain international corporate citizenship if by that term one means having facilities around the world that serve international markets. Canadians no longer are surprised to find in their local stores products made in Italy by American-headquartered companies, for example; they are more likely to find competitive Japanese products and services either supplied from Japan or North America.

Internationalization of Inputs - Japanese companies have been accused of exceeding the excess baggage allowance for overseas investors: even though they may leave home, they bring a lot of their home along with them, according to this argument. In particular, American trade officials and others have argued that Japanese firms operating abroad typically buy a great deal from Japanese suppliers, especially capital goods. In a related vein, they also point to Japanese multinationals' staffing, with its disproportionate numbers of Japanese nationals who are given little authority to act independently of the home office.

As suggested above, such actions may make perfect economic sense. Many analysts continue to see them, however, as barriers to foreign sales. A study by Mordechai E. Kreinin of Michigan State University lends support to their argument.[10] He picked the apparently neutral ground of Australia to contrast the behavior of Japanese, American and European subsidiaries with respect to the question of how closely tied the affiliates were to home offices and to home-country suppliers. His results appeared to confirm the arguments of those analysts who accuse Japanese firms of being parochial. Mr. Kreinin found, for example, that Japanese companies were far more likely to buy capital equipment from Japan without putting the order up for competitive bidding than were American and European companies, which differed relatively little from each other in this regard. Not surprisingly, Japanese companies ended up with Japanese equipment, while American and European companies appeared to buy from a large cross section of nations. European and American companies, moreover, were likely to be run by an Australian; Japanese companies typically were headed by a Japanese.

MITI data lend credence to Mr. Kreinin's arguments. In one undated study of manufacturing firms published in 1991 MITI compared Japanese firms abroad with foreign firms in Japan. (For details of foreign direct investment in Japan, see *JEI Report* No. 35A, September 20, 1991.) On each of 11 questions involving local control, foreign concerns in Japan were given more automony by their parents than their Japanese counterparts abroad. On some questions, such as marketing strategies, the differences were narrow, with both groups of subsidiaries being given wide latitude. On some long-term questions, however, Japanese companies were kept on a much shorter leash; almost 30 percent of the surveyed foreign firms could decide on their own to raise additional capital; fewer than 10 percent of Japanese firms could.[11]

The Kreinin study and the MITI survey suffer from some similar problems. The Japanese and the foreign firms in the Kreinin study were very different from each other in many ways having nothing to do with the parent's nationality. For example, they operated in different industries; in the

Kreinin study automotive companies and parts suppliers represented half the total Japanese sample while forming 12 percent of the European and American companies' representation. Otherwise, there was no industry overlap at all in the Kreinin study between the Japanese sample of 20 companies and the sample of 22 American firms and 20 European corporations. For example, seven of the U.S. and European companies were pharmaceutical or chemical companies; none of the Japanese companies were. Conceivably, differences by industry with respect to procurement and management could overwhelm whatever differences are attributable to the home country of the parent; Mr. Kreinin does not address this possibility.

In both the Kreinin and the MITI studies the non-Japanese firms had been operating abroad far longer than their Japanese counterparts, suggesting the possibility that Japanese companies will become more "naturalized" over time. Indeed, both Mr. Kreinin and MITI analysts found evidence that Japanese behavior is moving in that direction. A separate 1991 MITI study documented this trend. Its sample of Japanese investors worldwide showed that local procurement rose from 40.1 percent of all procurement in fiscal 1986 (April 1, 1986-March 31, 1987) to 47.9 percent in FY 1990. Similarly, imports from countries other than Japan by Japanese overseas affiliates rose from 6.9 percent to 7.3 percent of the total, implying that procurement from Japan dropped from 53 percent to 44.8 percent over four years. (Note that, since these figures do not include labor or capital costs, local content figures, which are inclusive of such items, would be far higher.)[12]

Some reseachers find evidence supporting Mr. Saxonhouse's statement implying that Japanese-owned subsidiaries operating in the United States also import relatively large proportions of inputs. The best known of these efforts is an Institute for International Economics study by Paul Krugman of the Massachusetts Institute of Technology and Edward M. Graham of IIE. They found that, compared to their mostly European counterparts, Japanese companies imported three times as much per worker from their home country, although the researchers were careful to note that their finding was tentative and may have reflected other factors, such as the relatively recent vintage of most Japanese investment.

Messrs. Graham and Krugman generally painted Japanese direct investment in this country in a favorable light from the American perspective. Their results support the impression from the production figures cited above that Japanese companies tend to concentrate their U.S. manufacturing investment in industries making products that use expensive labor. Not coincidentally, these same industries are highly productive from the host nation's standpoint. The two economists observed that research expenditures per worker at Japanese-owned firms in this country were higher than the U.S. manufacturing average (although lower than that of other foreign direct investors); salaries also were better than either the U.S. manufacturing average or those given by other foreign investors on average, and exports were above the average of other foreign investors. (No data were given for the exports of purely domestic firms.)[13]

Will Internationalization Be Successful?

Foreign direct investment — one of the principal components of a truly international company — has to overcome several inevitable obstacles to be successful. For example, Japanese companies investing in the United States have to possess or develop the skills to manage a heterogeneous work force — the most educated of whom probably have a better education than their Japanese managers, while the least educated of whom may be functionally illiterate, a condition almost unknown in Japan. Some of their American workers may speak a variant of English that even Japanese managers fluent in the language may find baffling. A large percentage of the pool of potential professional workers may be female, in considerable contrast to Japan. In addition to these personnel questions, Japanese managers have to deal with problems associated with communicating over long distances with the home office.

Despite these obstacles Japanese direct investment here typically is described in the American media as a smashing success. That conclusion is based largely on the experience of rising production levels and acceptance of the output of Japanese automotive companies. Yet, estimates based on Commerce Department data imply that the value of cars and trucks produced here as a percentage of the U.S. sales of Japanese affiliates in 1988 was 6 percent even after including manufacturing activities that typically have been misclassified under "wholesaling."[14] This statistic suggests that Japanese motor vehicle production in this country, while important, is not a sufficient basis to draw general conclusions about the success of Japanese-owned manufacturing facilities in the United States. In the long run Japanese automotive and other companies will maintain or expand only profitable operations; otherwise, competitive conditions dictate that capital be redeployed. (As if to demonstrate this point and to suggest that even Japanese automakers occasionally retreat, Nissan Motor Co., Ltd. announced in February that it was closing its Australian assembly operation, presumably one of the 20 Japanese firms studied by Mr. Kreinin.)

This argument suggests that profitability rather than a market presence is a key criterion of success for Japanese foreign direct investors, at least in the long run. According to a MITI study, Japanese-affiliated manufacturing firms in North America showed negative changes in retained earnings (dividend payments and similar charges exceeded profits) in FY 1989; this suggests that profits probably were negative since dividends and other payments typically are small. Additions to retained earnings were positive in Asia and Europe, however.[15] Profits on all direct investments worldwide among the sample companies showed an up-and-down pattern during the 1980s, although they rose from FY 1980's level of ¥618 billion ($2.9 billion at ¥213.1=$1.00, the relevant exchange rate for that period) to ¥950 billion ($6.7 billion at ¥141.28=$1.00, the average exchange rate for the April 1990-March 1991 period) in FY 1990.[16] During the same time overseas assets increased in value 7.5 times, suggesting that profit rates plummeted. However, these results also reflect, in part, high start-up costs and the strong yen, which translated the dollar returns into fewer yen, other factors equal. In short, at a minimum, the profitability data suggest that direct investment abroad has not yet achieved a primary goal and is not currently on a clear trend to do so.

Conclusion

Corporate Japan's uneven success to date in earning profits from its overseas investments may be of only limited relevance to the future prospects for direct investment abroad. As Japanese companies' hiring practices become diversified in response to pressures to "go native," they may or may not find equal success. Japanese financial services firms, which employ an overwhelmingly white-collar work force, appear to have struggled compared to their manufacturing brethren, who hire more blue-collar workers. Even Japanese manufacturers, though, seem to have trouble attracting and keeping middle management in their operations abroad.[17] For these reasons the jury still is out as to whether Japanese direct investment abroad will be successful in the 1990s.

On the broader question of whether Japanese firms are becoming internationalized, the answer is that they have made substantial progress, although they fall short of what policymakers in host countries would like. Whether their tendency to look toward Japan for people and products will fade over time and whether Japanese firms will be able to prosper in a multinational environment are among the key questions facing Japanese companies in the 1990s.

For further information, contact **Douglas Ostrom**.

Dan Levison provided research assistance.

Notes

[1] For a brief discussion of the theoretical underpinnings of multinational firms and direct investment abroad, see Edward M. Graham and Paul Krugman, *Foreign Direct Investment in the United*

States (2nd ed; Washington, D.C.: Institute for International Economics, 1991), pp. 35-38 and pp. 177-179) and the references cited therein. The best-known source on this subject probably is Richard E. Caves, *Multinational Enterprise and Economic Analysis* (Cambridge, England: Cambridge University Press, 1982). See also A.M. Rugman, "Internationalization as a General Theory of Foreign Direct Investment: A Reappraisal of the Literature," *Weltwirtschaftliches Archiv*, Bd. CXIV, No. 198, 1980, pp. 365-379.

[2] For a discussion of direct investment abroad during this period, see Lawrence Krause and Sueo Sekiguchi, "Japan and the World Economy" in Hugh Patrick and Henry Rosovsky (eds.), *Asia's New Giant* (Washington, D.C.: Brookings Institution, 1976), pp. 447-450. For 12 articles on Japanese investment in the United States in recent years, see Kozo Yamamura (ed.), *Japanese Investment in the United States: Should We Be Concerned?* (Seattle, Washington: Society for Japanese Studies, 1989). Some of the articles in this volume focus primarily on portfolio investment, in which Japanese companies are assumed to play a more passive role than with direct investment.

[3] For details, see Donald J. Daly, "Exchange Rates and Trade Flows," *Business and the Contemporary World* (special issue), 1992 (forthcoming).

[4] The Ministry of Finance data have serious flaws in many respects. The figures are based on the announced intentions of Japanese firms — "approvals," but no adjustment is made if firms do not follow through on their plans. Nor is any adjustment made in later periods for investments that decrease (or increase) in value, which are sold to Japanese or non-Japanese firms, or which mysteriously disappear. In contrast to the MOF data, the BOJ numbers contain several important adjustments that make the figures smaller in aggregate. However, BOJ data are not available by region or industry.

[5] Economic Planning Agency, *Keizai Hakusho* (Tokyo, Japan: Okura-sho, 1991), pp. 308, 494.

[6] Ministry of International Trade and Industry, *Tsusho Hakusho* (Tokyo, Japan: Okura-sho, 1991), p. 214.

[7] *Ibid.*

[8] Written statement of Gary R. Saxonhouse before the Joint Economic Committee, December 17, 1991, p. 6.

[9] MITI, *op. cit.*, p. 223.

[10] Mordechai E. Kreinin, "How Closed is Japan's Market? Additional Evidence," *The World Economy*, XI, No. 4, pp. 42-52. For a critique, see Gary R. Saxonhouse, "How Open is Japan? Comment" in Paul Krugman (ed.), *Trade with Japan: Has the Door Opened Wider?* (Chicago, Illinois: University of Chicago Press, 1991), pp. 41-42.

[11] MITI, *op.cit.*, p. 225. For results of a related study, see EPA, *op. cit.*, pp. 352 and 504.

[12] Ministry of International Trade and Industry, "Kaigai Jigyo Katsudo Doko Chosa no Gaiyo" (Tokyo, Japan: December 1991), p. 16.

[13] Edward M. Graham and Paul R. Krugman, *Foreign Direct Investment in the United States* (Washington, D.C.: Institute for International Economics, 1991), pp. 74-80. Additional analysis of the role of Japanese and other foreign direct investors in the U.S. economy is found in Department of Commerce, *Foreign Direct Investment in the United States* (Washington, D.C.: Government Printing Office, 1991). The survey includes case studies of the electronics, automotive, steel, chemicals and banking industries.

[14] The figure is estimated based on data from Department of Commerce, *Ibid.*, p. 54.

[15] MITI (1991), *op. cit.*, p. 216.

[16] MITI (December 1991), *op. cit.*, p. 20.

[17] See Haruo Shimada, "Japanese Management of Auto Production in the United States: An Overview of 'Humanware Technology'" in Kozo Yamamura (ed.), *Japanese Investment in the United States: Should We Be Concerned?* (Seattle, Washington: Society for Japanese Studies, 1989), pp. 199-200.

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JAPAN · ECONOMIC · INSTITUTE

JEI REPORT

A Two-Part Report: A and B

NO. 9B
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Miyazawa Tries To Expedite Political Reform

Reeling from recent revelations of suspected corrupt behavior within the ruling Liberal Democratic Party and the related defeat in early February of a LDP-backed candidate in an upper house by-election in Nara prefecture, Prime Minister Kiichi Miyazawa has sought to expedite Diet action on legislation aimed at reforming Japan's political system. Mr. Miyazawa called on ruling party officials February 21 to compile a package of political reform bills by mid-March for enactment during the current Diet session. During a 90-minute meeting the prime minister outlined to Takashi Hasegawa, head of the LDP's political reform committee, chief cabinet secretary Koichi Kato and Home Affairs Minister Masajuro Shiokawa what he termed "urgently needed" changes in the political system. Mr. Miyazawa's four main targets are: correcting the disparities in the values of rural and urban votes; tightening controls on political fund-raising; stiffening penalties on politicians who have engaged in unethical and/or illegal behavior; and reducing the costs of elections and, in general, the expenses related to the "business of politics."

Mr. Miyazawa is scrambling to avoid the fate of former Prime Minister Noboru Takeshita, who was forced to announce his resignation in April 1989 to accept responsibility for the loss of public faith in the ruling party due to the Recruit Co., Ltd. influence-peddling scandal. Although LDP doyens last fall effectively killed a similar package of political reform measures advanced by former Prime Minister Toshiki Kaifu (see *JEI Report* No. 38B, October 11, 1991), the domestic political scene has been altered since then. In January the former secretary general for Mr. Miyazawa's faction was

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their American manufacturing facilities. This act, if confirmed, would be anticompetitive and clearly within the reach of U.S. law since it occurs on American soil. As a practical matter, however, antitrust authorities have tended to deemphasize noncompetitive buying practices by U.S. firms on the grounds that exercising market power as a buyer is difficult, as is determining the extent of exclusion. Coming down hard on Japanese firms for these practices would represent a departure for Justice.

The ideas that the attorney general floated in February would go considerably beyond this situation, however. Press reports suggested that Mr. Barr was raising the possibility of targeting exclusionary buying practices in Japan and other foreign countries. In other words, a potential U.S. exporter shut out of the Japanese market because of these actions could be a victim. Stretching the law this far into an area of obvious extraterritoriality would appear to raise further doubts as to whether the law was protecting certain competitors (would-be American exporters) rather than U.S. competition in general. The question arises because anticompetitive actions in the Japanese market would appear to have negligible effects on competition in the U.S. market, the apparent objective of U.S. antitrust statutes up to now.

Mr. Barr's trial balloon has attracted considerable sniping within the Bush administration and in Tokyo as well. In part, the complaints in Washington have been over turf; market-opening measures in Japan and elsewhere traditionally have "belonged" mainly to the Office of the U.S. Trade Representative and the Departments of Commerce and State. Only Commerce among this triumvirate appeared to support Justice's emerging role.

In Japan the initiative was seen as an instance of meddling in that country's internal affairs. Japan has its own antitrust law; if an infraction of that law, which is broadly similar to U.S. statutes, occurs on Japanese territory, then Japan's law should be applicable, according to Tokyo. (For details of Japan's law, see *JEI Report* No. 20A, May 19, 1989.) Coincidentally, a blue-ribbon advisory panel to the FTC recommended March 2 that the maximum criminal penalty under the Antimonopoly Law be increased from the current ¥5 million ($37,000 at ¥135=$1.00) to at least ¥300 million ($2.2 million), an action that Washington has advocated.

Within a week of Mr. Barr's disclosure, Tokyo had called for a review of his proposals during the May meeting of the competition committee of the Organization for Economic Cooperation and Development, of which both the United States and Japan are members. In this forum Tokyo expects to get the support of the European Community. While internal and external opposition to the trial balloon launched by Mr. Barr eventually may ground it, the heated oratory regarding U.S.-Japan relations in this election year may give the initiative enough of a high profile to keep it floating at least through November.

Douglas Ostrom

EC Clamors For Japanese Attention

The February 16-21 visit to Japan by European Community Commission vice president Sir Leon Brittan revealed anew the troubled state of Japan-EC ties, although it was overshadowed by flare-ups in U.S.-Japan frictions and domestic political scandals. Not only are EC officials concerned about the sharp rise in Japan's trade surplus with the community, but they equally are worried about what is seen as Tokyo's continued policy favoritism toward Washington. By stressing growing government and private ties, EC representatives are pressing Tokyo to give more attention to European matters and prevent simmering irritations from reaching the boiling point.

Japan's dollar-denominated trade surplus with the European Community reversed course in 1991. After two years of contraction, it jumped 48.4 percent to a record $27.4 billion (see Table). While Japanese exports posted a solid 10.6 percent gain in 1991, imports from the EC shrank 9.3 percent, turning in their first negative performance since 1985. The figures are only slightly less

Japan's Trade with the European Community and Selected EC Members, 1987-91

a. in millions of dollars and percent change

	Exports		Imports		Balance	
	Value	Change	Value	Change	Value	Change
European Community						
1991	$59,163	10.6%	$31,788	-9.3%	$27,376	48.4%
1990	53,510	11.7	35,063	24.6	18,447	-6.6
1989	47,908	2.2	28,146	16.9	19,761	-13.3
1988	46,873	24.3	24,071	36.2	22,802	13.9
1987	37,693	22.9	17,670	26.3	20,023	20.0
Great Britain						
1991	11,019	2.2	5,021	5.4	5,997	-0.3
1990	10,782	0.4	4,765	6.7	6,017	-4.1
1989	10,741	1.0	4,466	6.5	6,275	-2.5
1988	10,632	26.5	4,193	37.2	6,439	20.5
1987	8,400	26.4	3,057	-14.4	5,343	73.8
West Germany						
1991	20,620	16.0	10,730	-6.6	9,890	57.2
1990	17,777	11.7	11,487	27.7	6,290	-9.2
1989	15,920	0.8	8,995	10.9	6,925	-10.0
1988	15,793	23.1	8,101	31.8	7,692	15.1
1987	12,833	22.5	6,150	43.1	6,683	8.2
France						
1991	6,121	-0.0	5,808	-23.4	313	*
1990	6,124	15.6	7,586	26.8	-1,462	489.5
1989	5,298	6.3	5,546	28.6	-248	*
1988	4,986	24.2	4,313	50.2	673	-41.1
1987	4,014	27.3	2,871	54.8	1,143	-11.9
Italy						
1991	3,789	11.1	4,533	-9.5	-743	-53.5
1990	3,410	22.5	5,007	31.6	-1,597	56.1
1989	2,783	-0.0	3,806	31.6	-1,023	847.2
1988	2,787	32.5	2,895	35.5	-108	237.5
1987	2,103	22.1	2,135	42.8	-32	*

b. in millions of yen and percent change

	Exports		Imports		Balance	
	Value	Change	Value	Change	Value	Change
European Community						
1991	¥7,969,888	3.1%	¥4,282,990	-15.6%	¥3,686,898	38.7%
1990	7,732,983	17.6	5,075,360	31.1	2,657,623	-1.8
1989	6,577,895	9.6	3,870,210	25.6	2,707,685	-7.3
1988	6,002,754	9.4	3,082,865	20.2	2,919,898	-0.1
1987	5,487,963	6.1	2,564,847	9.2	2,923,116	3.5
Great Britain						
1991	1,484,289	-5.0	676,539	-10.6	807,750	0.2
1990	1,562,177	6.0	756,426	23.4	805,751	-6.3
1989	1,473,087	8.2	612,966	14.3	860,121	4.2
1988	1,361,791	11.6	536,179	21.0	825,612	6.2
1987	1,220,781	8.7	443,096	-25.3	777,685	46.8
West Germany						
1991	2,779,085	8.3	1,445,161	-13.0	1,333,924	47.7
1990	2,564,922	17.3	1,661,698	34.3	903,224	-4.9
1989	2,186,563	8.1	1,237,021	19.2	949,542	-3.7
1988	2,022,411	8.1	1,036,659	16.2	985,752	0.8
1987	1,871,028	5.9	893,045	23.1	977,983	-6.0
France						
1991	824,471	-6.9	782,430	-28.8	42,041	*
1990	885,982	21.8	1,098,417	44.2	-212,435	413.3
1989	727,250	13.9	761,886	37.8	-34,636	*
1988	638,717	9.4	553,056	33.0	85,661	-49.0
1987	583,796	9.7	415,691	33.4	168,105	-23.8
Italy						
1991	510,137	15.4	611,633	-15.9	-101,496	-64.4
1990	442,149	15.5	727,191	38.6	-285,042	101.2
1989	382,827	7.3	524,524	41.3	-141,697	876.7
1988	356,830	17.0	371,337	19.3	-14,507	138.0
1987	305,111	5.1	311,206	24.1	-6,095	*

*Meaningless

Source: Ministry of Finance

striking when viewed in yen terms. Export growth slowed from 17.6 percent in 1990 to 3.1 percent last year, but imports recorded a 15.6 percent drop as opposed to a 31.1 percent increase the year before. That combination boosted the bilateral surplus 38.7 percent after three straight years of modest reductions.

Trade with four EC members — Great Britain, Germany, France and Italy — continued to represent the bulk of activity; the four countries typically buy about 70 percent of Japan's exports to the community and supply 80 percent-plus of Japan-bound shipments. These trading partners, however, accounted for only $15.5 billion or 56.5 percent of Japan's trade surplus with the entire community. Moreover, only the imbalance with Germany went up, most likely because of increased demand for imports caused by reunification. Great Britain alone managed to increase exports to Japan, as the slowing Japanese economy pulled in fewer imports.

Just as in U.S.-Japan relations, trade in motor vehicles is a prominent issue in EC-Japan ties. European automakers have enjoyed rising sales in Japan thanks to strong marketing efforts and investments in their own dealer networks. Slower Japanese economic growth, however, trimmed total car sales in Japan last year and cut sales of imported vehicles 11.1 percent. On behalf of frustrated European automotive industry officials Peter Woods, president of Rover Japan, Ltd. and head of the European Business Council's automobile committee, recently charged Tokyo with breaking its word, pointing to a 1991 Japan-EC agreement that calls for "mutually supportive growth" of imports in each market (see *JEI Report* No. 20B, May 24, 1991). While saying that Japan's car market basically is open, Mr. Woods pushed for action by Tokyo to counter consumers' psychological resistance to buying foreign. This "affirmative action" plan would include raising the import share of Japan's car market from the current 4 percent-plus to 10 percent in 1995 and then to 17.5 percent by the end of this century.

Mr. Woods, who led a committee delegation to Tokyo on the heels of President Bush's Japan trip, said that his group would petition the EC Commission to work for an import-expansion pledge from Tokyo similar to that gained by Mr. Bush. The January pledges by Japan's five biggest automotive manufacturers to boost imports of American cars and auto parts (see *JEI Report* No. 2B, January 17, 1992) had prompted the EC Commission to warn, "We are now inclined to think there is discrimination [by Japan in automotive trade]. To the extent that there is discrimination, we will oppose it." That warning presages an EC challenge to Japan's automotive pledges to the United States, just as the community successfully challenged some aspects of the 1986 U.S.-Japan semiconductor trade agreement. Mr. Woods noted, however, that the picture is not completely bleak. "There have been a large number of parts manufacturers in Japan from Europe for quite a long time," he said, adding, "Most of them are really quite successful."

As for sales of Japanese cars in the community, Tokyo and Brussels continue to haggle over the meaning of their 1991 pact. While it is clear that Japanese automakers will be allowed to expand EC sales gradually through 1998 and then have unhindered access to the EC market, the pact is silent as to exactly what constitutes an "import." European automotive makers remain split over whether vehicles produced by Japanese subsidiaries within the community qualify as imported makes or domestics. The Association of European Automobile Constructors issued a call January 27 for the EC to classify as imports from Japan any cars made by Japanese subsidiaries in the United States and shipped to the European Community. Since the Office of the U.S. Trade Representative already has sided with Honda Motor Co., Ltd.'s American subsidiary in support of a designation of its cars as U.S.-sourced imports in a similar French case, a clash between Washington and Brussels seems inevitable on the communitywide issue.

During his visit to Japan the EC's Mr. Brittan pushed Tokyo for faster liberalization of Japanese service markets, particularly in the financial sector. In an echo of U.S. demands the commission vice president called for quicker deregulation of interest rates and greater opportunities for foreign entry into Japanese financial markets, especially insurance. Claiming that Tokyo so far has favored American companies in its deregulation drive, Mr. Brittan sought better treatment of European banks and securities firms. In his dual role as EC commissioner for competition as well as EC Commission vice president, Mr. Brittan applauded recent enforcement actions by Japan's Fair Trade Commission, but he charged that both government and industry leaders in Japan continue to favor cartels and other anticompetitive arrangements at home. He did not comment, however, on a recent Department of Justice decision to explore the use of U.S. antitrust laws to combat such Japanese practices (see preceding article).

Continuing an EC attempt to engage Japan in constructive activities, Mr. Brittan pointed out as areas of promising cooperation several joint research and development agreements at both the government and the private level. On February 24, for example, the European Space Agency and Japan's Science and Technology Agency tentatively agreed to codevelop a space shuttle and related equipment. The effort would build on existing, separate development efforts: ESA's Hermes manned space shuttle and STA's unmanned HOPE (H-II orbiting plane) project. Also included would be training of Japanese and European astronauts.

The EC is pressing for Japanese cooperation on other fronts as well. Last November, for example, the EC urged Tokyo to take a more active role in the stabilization and economic reform of the former Soviet Union and Eastern European nations. At a planned March 9-10 ministerial-level meeting the two sides are expected to build on their historic 1991 pact calling for greater political and economic cooperation (see *JEI Report* No. 28B, July 26, 1991). Trade, however, remains the central issue in bilateral talks. Japan and the European Community will exchange lists of trade barriers in April or May, perhaps leading to talks similar to the U.S.-Japan Structural Impediments Initiative discussions.

Jon Choy

Washington, Tokyo Examine Ways To Revive SII Process

Japanese government officials never were comfortable with the system put in place to monitor implementation of the sweeping structural economic reforms promised by Tokyo and Washington in the June 1990 report on the Structural Impediments Initiative talks. They worried that the U.S.-crafted follow-up mechanism would encourage the White House to expect short-term solutions to problems that were solvable only over time. More important, Japan's negotiators felt the tracking system adopted could turn the yearlong SII exercise into an open-ended process.

Tokyo's worst fears materialized last November when Bush administration officials from the president on down started talking about the need to "revitalize" SII. That proposal caught the Japanese government off guard. Trade officials knew only too well from the first SII progress report and the discussions preceding the release of this May 1991 document that their American counterparts were dissatisfied with what Tokyo had done or planned to do to address exclusionary business practices in Japan, *keiretsu* relationships and land-use policies, three of the six areas identified by Washington as contributing to the perpetuation of big bilateral trade imbalances (see *JEI Report* No. 22B, June 14, 1991). Nothing said at the time or included in the report suggested, however, that Washington's criticism would led where it did.

Not surprisingly, Japanese trade policymakers reacted coolly when Washington first floated the idea of injecting new life into the SII process. Their response did not change even after White House officials sought to reassure them that all the administration had in mind was new or expanded commitments from Tokyo for action in the six areas targeted originally, not extension of the SII exercise to other fields. In the end, though, the government of Kiichi Miyazawa reluctantly agreed during Mr. Bush's January Japan trip to "reinvigorate" SII by "strengthening policy initiatives, including new commitments to address the aspects of the business environment of both countries that might impede structural reform, including market access, foreign investment and competitiveness."

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REPORT

A Two-Part Report: A and B

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March 13, 1992

JAPAN VIEWS LEADERSHIP OPPORTUNITIES THROUGH THE UNITED NATIONS

SUMMARY

Japanese media heralded Prime Minister Kiichi Miyazawa's address to the late January summit of the 15 members of the United Nations Security Council as an important departure from Japan's heretofore passive diplomatic tradition. In calling for an overhaul of the U.N.'s organization and functions, Mr. Miyazawa came about as close as any Japanese leader has in this or other international forums to making a formal request that Japan receive a permanent seat on the Security Council. Such a status, some Japanese policymakers have argued, would reflect more fairly Japan's emergence as a global economic power and its related, sizable contributions to the U.N. budget. Permanent membership on the Security Council also would enable Tokyo to demonstrate its interest in helping to foster global peace and stability through actions other than "writing checks."

While Japan gradually has assumed a higher profile on a variety of political and economic issues considered by the United Nations, it is questionable whether Tokyo really is prepared to assume the attendant obligations of permanent Security Council membership. On a practical level the Japanese government does not have enough qualified personnel at the United Nations, particularly at the secretariat level, to significantly affect policy development and, in general, support a much expanded role. More fundamentally, the Japanese public may not yet support the country's assumption of major power responsibilities, judging by Tokyo's inability during the past year and a half to enact legislation that would authorize Japanese participation in U.N.-sponsored peacekeeping activities.

The United States and other permanent Security Council members also are opposed to reconfiguring the U.N. leadership structure at this time because that would entail amending the charter. Washington fears that such an action would precipitate a snowball effect from other member countries demanding changes. Rather than fighting domestic and international sentiments — or waiting idly for these views to evolve, Tokyo's foreign policy professionals instead may nudge Japan toward global center stage by quietly and gradually building a record of policy achievements within the United Nations and/or other multinational organizations.

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Japan Looks to United Nations to Play Global Role

Kindred Philosophies - Tokyo has placed a high priority on being a full participant in the United Nations and its specialized agencies since becoming a member in 1956. The Ministry of Foreign Affairs in its annual diplomatic "blue books" typically has characterized Japan's foreign policy as being "U.N.-centered." To a nation that nearly 47 years ago formally renounced war as a means of settling international disputes, this multinational organization appears to embody the pacifist ideals embraced by a defeated people.

Once Japan began formulating its own diplomatic guiding principles after the occupation ended in 1952, the government readily adopted the peace preservation goals outlined in the U.N. charter. Thus, like this giant multinational body, Tokyo's external relations have been shaped by a desire to help maintain international political stability, promote world economic development and facilitate global dispute settlement. These goals correspond nicely with participation in the United Nations, at least in the view of Japanese officials. Robert Immerman of Columbia University's East Asian Institute suggests that the pacifist fabric making up the United Nations embodies so well the pattern that Japan outlined in its "peace constitution" 40-odd years ago that membership and participation in this multilateral organization is perhaps the only aspect of Japan's postwar foreign policy on which there has been virtual agreement across that country's political spectrum.[1]

With Japan's emergence as a global economic power and related calls from the United States and other allies for Tokyo to assume more international leadership responsibilities, the United Nations has been a logical channel through which the Japanese government has tried to demonstrate its willingness to help develop solutions to international political and economic issues. By working under the auspices of this multinational body, Tokyo has minimized the risk of a potential backlash from a strongly pacifist and isolationist public that generally has been averse to a more active, self-initiated diplomacy. At the same time the Japanese government could address international criticism about its apparent unwillingness to behave like a world-class power by pointing to its U.N. activities.

Raising Japan's Profile, Gradually - While Tokyo by and large follows Washington's lead in the United Nations — as it has on most foreign policy issues during the postwar period (see *JEI Report* No. 3A, January 24, 1992), some analysts view the mid-1980s as the period in which the Japanese government began to seize the initiative on a number of issues pertaining not only to the United Nations but to global and regional matters as well.

At that time the multinational organization appeared to be suffering from an image problem. Many members of the international community perceived the United Nations to be ineffective in handling frontline issues. The Middle East peace process, initially energized by the 1978 Camp David accords, was one issue going nowhere in the mid-1980s despite the adoption over the years of several resolutions as well as extensive General Assembly debate. Moreover, attention had begun to shift to such multilateral concerns as international finance and developing-country debt, which are handled primarily by other international agencies, such as the Organization for Economic Cooperation and Development, the World Bank and the International Monetary Fund.

Japanese officials reportedly began reassessing the value of the United Nations and their country's role in it. Evidently, there was a body of opinion during the early 1980s that supported devoting more of Japan's resources to bilateral matters because of the increasingly questionable diplomatic payoffs of multilateralism. Some analysts maintain that President Ronald Reagan's lack of support for the United Nations during his two terms in office marked an important turning point in Tokyo's reexamination of its motives for seeking a larger role in the United Nations and its associated

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agencies. Mr. Immerman, for one, observed that "lack of consultation became the order of the day." Japanese foreign policy professionals apparently were troubled by U.S. Ambassador to the U.N. Jeane Kirkpatrick's use of highly confrontational tactics, which some say were designed to justify a de facto end to U.S. participation in the United Nations.

The Japanese government broke free of its passive mode partly in response to Washington's acting to withhold a major portion of America's assessed contribution to the U.N. budget. The withholding amendment was attached to State Department authorization legislation, which was enacted in August 1985. The Japanese government reacted by proposing that the United Nations form a special panel to consider how to reform the multilateral organization's administrative and budgetary processes. Japanese policymakers realized that if they simply stood on the sidelines and allowed U.S. behavior to go unaddressed they would risk undermining the country's fundamental diplomatic principles, enraging public opinion and contravening international pressures to become increasingly involved in global affairs (see *JEI Report* No. 18A, May 9, 1986). Japan's foreign policy professionals also realized that, as the second-largest U.N. contributor at that time, Tokyo probably would be pressured to make up a considerable portion of the shortfall in the 1985 U.N. budget, of which an estimated $240 million was attributable, in part, to Washington's action.

Then Foreign Minister Shintaro Abe's September 1985 proposal to establish an 18-member group of intergovernmental experts to review U.N. administrative and financial matters put Japan on a new, higher-profile path in this multilateral organization. After strong initial opposition from certain American officials, the General Assembly adopted a resolution in December 1985 to establish the group. The special panel's recommendations, which Japan played an active role in drafting, were approved about one year later, and Washington gradually resumed its support payments.

Another unsettling U.S. policy action was Washington's 1985 decision to withdraw from UNESCO (the United Nations Educational, Scientific and Cultural Organization) on the grounds that the organization was mismanaged, blatantly politicized and anti-Western. Great Britain also withdrew from UNESCO, which placed pressure on Japan to act similarly. Coming at about the same time as Washington's budget action, Tokyo did not want differences over UNESCO or other U.N. issues to become another irritant in increasingly contentious relations with the United States. Yet neither did the Japanese government want to be forced to resign from an agency that afforded it an opportunity to make nonmilitary contributions to global stability. In another show of independence policymakers said Japan would remain a UNESCO member and would try to correct the agency's problems from within.

From 1985 on Japan appeared more at ease in assuming a higher profile on a variety of political issues outside its immediate sphere. For example, Japanese diplomats evidently played an important mediating role in the drafting of a U.N. resolution that mandated the settlement of the Iran-Iraq War. During the late 1980s Tokyo also contributed civilian observers to U.N.-sponsored peacekeeping missions in Afghanistan, Iran/Iraq and Namibia. In terms of extending help to its neighbors, the Japanese government in 1990 stated its intention of pursuing a substantial role in supporting U.N.-sponsored efforts to bring peace to Cambodia (see *JEI Report* No. 2B, January 12, 1990).

Foreign Ministry officials also emphasize that throughout Japan's 36 years in the United Nations Tokyo always has played a leadership role on nuclear disarmament and arms proliferation questions due to the country's own experience as the victim of an atomic bomb. These initiatives go back as far as the early 1960s, when the Japanese government championed nuclear test ban and nonproliferation agreements. Tokyo's call for vigilance on weapons issues continues today. Speaking before the General Assembly last September, then Foreign Minister Taro Nakayama urged the United Nations to establish a registry for international transfers of conventional arms and called for stepped-up international inspection of nuclear facilities and the conclusion of a chemical weapons convention (see *JEI Report* No. 37B, October 4, 1991).

Some analysts maintain, therefore, that it is unfair and incorrect to allege that Tokyo has not heard allies' calls for greater international political and economic burdensharing. Japan's foreign policy professionals for the past decade have been aware that this economic giant has to become more engaged in world affairs (see *JEI Report* No. 3A, January 24, 1992). But rather than drawing attention to their actions, foreign policymaking elites in Tokyo instead have chosen to begin expanding incrementally the country's role in managing global political and economic issues by working within the United Nations, a global forum highly respected by the Japanese public.[2]

Persian Gulf Crisis Paralyzes Japan, Polishes U.N. Image

The global crisis that resulted from Iraq's August 1990 invasion of Kuwait set back Japan's foreign policy professionals in their efforts to expand the country's involvement in global affairs, both in general and with particular significance within the U.N. context. At the time of the Security Council's sometimes marathon discussions concerning how to redress Iraq's contravention of international legal and diplomatic practices, Japan was not among the 10 nonpermanent members of the council. This not only permitted Japan a low profile but frustrated Tokyo, which knew it would be called on for financial support of any Security Council action.

Japan's eventual contribution of $13 billion in nonmilitary support of the coalition forces arrayed against the Iraqi army came after drawn out debate in Tokyo, which suggested that Japan did not share its allies' views of the gravity of developments in the Persian Gulf region. Moreover, the Japanese government's protracted deliberation of legislation that would have authorized the overseas dispatch of Japanese military and civilian personnel to participate in U.N.-sponsored peacekeeping operations — and the measure's November 1990 demise — also gave the impression that the country simply was unwilling to break new ground in supporting the multilateral organization's efforts to foster world political stability. Given the general international impression that developments in the Middle East required bold, immediate action, Tokyo appeared out-of-step, being unable — some have said unwilling — to deliver for a variety of reasons relating to public sentiment, domestic politics, political leadership and the nature of foreign policymaking in Japan (see *JEI Report* No. 3A, January 24, 1992).

However, the United Nations' authoritative handling of the Persian Gulf crisis — its swift and sure action on resolutions imposing economic sanctions and, ultimately, mandating Iraq's withdrawal from Kuwait by a certain date — served to resuscitate the U.N.'s image as a vital forum for settling disputes as well as developing and implementing policies aimed at securing global peace. In the words of a Japanese diplomat who wished to remain anonymous, the Middle East crisis "reemphasized the role and spirit" of the United Nations and, in so doing, appeared to restore the faith of some Japanese in multilateral diplomacy. Whereas some policymakers in the early 1980s had come to question the effectiveness of this multilateral organization, many more believed that the United Nations had proven itself through the Persian Gulf crisis to be a very useful forum for managing systemic transition in the post-Cold War period.

Although undoubtedly embarrassed by the criticism accorded Japan for its performance during the Persian Gulf crisis, Tokyo last year evidently found it easier to exploit the resurgent popularity of the United Nations domestically than to address seriously the factors that had paralyzed the government at a time when its allies expected the country to rise to the occasion. The Japanese government seized its U.N. membership responsibilities with new vigor, in part to demonstrate to both domestic and international audiences that — notwithstanding its behavior during the Middle East crisis — Tokyo was willing and able to play an expanded international role.

Japanese government officials lobbied hard to regain a rotating seat representing Asia on the Security Council. The assignment, which began this past January 1, marks an unprecedented seventh two-year term for Japan. Observers have suggested that Japan's ability to gain one of the rotating seats indicates the U.N. membership's recognition of Japan's increasing role in world affairs. Tokyo also campaigned effectively for the appointment of Yasushi Akashi, the most senior Japanese national in the U.N. secretariat, to be United Nations Special Representative in Cambodia. In other areas, too, Tokyo has behaved more assertively on policy questions pertaining to Asian security, such as opposing North Korea's alleged effort to develop nuclear capabilities. In addition the government has pushed initiatives to strengthen the United Nations' peacekeeping functions. For example, former Foreign Minister Nakayama proposed to the September 1991 General Assembly meeting the establishment of a "conflict-prevention system," which would upgrade the secretariat's ability to gather and analyze information on potential areas of conflict so that preemptive diplomatic measures could be taken.

Mr. Nakayama also went public with an issue that long has troubled Tokyo when he urged the deletion of two clauses of the U.N. charter that brand Japan and Germany as "enemy states." His argument was simple: the world situation had changed dramatically since 1945 when these provisions were adopted (see *JEI Report* No. 37B, October 4, 1991). Further elevating Japan's profile in the United Nations, Prime Minister Kiichi Miyazawa attended the late January summit of the five permanent and 10 rotating members of the Security Council. This first-ever gathering of leaders under Security Council auspices was called by British Prime Minister John Major, in part, to maintain the spirit of cooperation established during the gulf crisis.

Against this backdrop certain senior Japanese officials and parliamentarians have revived a campaign to revise the U.N. charter to allow Japan to join the United States, Russia (which inherited the seat formerly held by the Soviet Union), Great Britain, France and the People's Republic of China as a permanent member of the Security Council. Since the late 1950s Japanese policymakers periodically have tried to press this issue but have not been successful for a variety of reasons. This time around, however, the bid for a permanent seat was offered from the top. Mr. Miyazawa, in his address to the late January Security Council summit, called on members to "consider thoroughly ways to adjust [the U.N.] functions, composition and other aspects so as to make it more reflective of the realities of the new era." This was the first time in an international forum that a Japanese leader had articulated, even in somewhat indirect terms, the country's aspiration for permanent Security Council status.

Observers caution, however, that Japan's increased activities in the United Nations during the past two years, and particularly Tokyo's campaign for a permanent seat, do not necessarily portend a dramatically higher profile for Japan in the United Nations or in world affairs in general. Not enough spade work has been done within the foreign policy bureaucracy, the Diet and among opinion leaders concerning Japan's intentions within the United Nations and how a permanent seat would facilitate Japan's foreign policy goals, they point out. Foreign Ministry officials confirm that a unified, coherent view of Japan's role in the United Nations simply does not exist yet. Japan's more recent busy behavior instead may represent an effort to deflect preemptively international criticism that Japan does not "do enough" in the global arena.

Differing Views on Japan's Role in the United Nations

Japan's efforts to carve out a new role for itself in the United Nations will be pushed and pulled in different directions. It is unclear when, if at all, some policy cohesion will emerge. According to Mr. Immerman of Columbia University, Japan's foreign policy professionals (which he defines as bureaucrats and academics linked to the Foreign Ministry and the Finance Ministry) may find themselves butting heads with Japanese politicians and business executives over how the country should participate in this organization. Even a consensus among these parties could have trouble winning acceptance from the Japanese public.[3]

Political/Business Elites - Influential politicians and businessmen have been strong proponents of the call for a permanent Security Council seat for Japan. This group's primary concern appears to be obtaining for Japan the prestige associated with permanent member status. As an economic giant whose actions have ripple effects throughout the world, Japan simply deserves this position of influence to place it on a par with other major powers, this group argues. Japan's ability as a permanent Security Council member to affect policy development and alter budgetary and administrative guidelines ranks lower as a concern to these politicians and businessmen.

Foreign Policy Professionals - Foreign policy professionals' view of Japan's role in the United Nations is more complex. Judging by the remarks of some Foreign Ministry officials, there does not appear to be a lot of urgency attached to resolving the permanent seat issue. While Japanese press reports quoted senior government officials as saying that Mr. Miyazawa's remarks at the January summit were meant to be heard as Tokyo's request for a permanent seat, Japanese diplomats have emphasized the indirect nature of Mr. Miyazawa's remarks. "The prime minister did not explicitly request a permanent seat for Japan," said one Foreign Ministry official who did not wish to be identified. "We have not really tabled an official candidature."

Japanese foreign policy professionals suggest that their energies and attention first should be devoted to developing a "vision" of Japan's role in the new world order. Only after more clearly grasping the country's foreign policy goals will policymakers be able to understand how best to utilize the United Nations to achieve them, this group maintains. In addition, those diplomats involved in U.N. affairs point out that they have achieved the most progress in expanding Japan's role in this body by proceding in a quiet, gradual manner.

They also scoff at those politicians and business leaders who are concerned only with the prestige that comes with being a permanent member of the Security Council. Japanese diplomats say there is a very strong view within the Japanese foreign policy community that the country should be doing more to contribute to the resolution of global issues than making financial contributions. "Being a permanent member of the Security Council is not just a 'status symbol;' it brings with it many responsibilities and obligations," a Foreign Ministry official recently remarked.

This group also appears more sensitive to the implications of opening the U.N. charter for revision. The United States, while not opposing outright a permanent Security Council seat for Japan, has objected strongly to changing the charter for fear of precipitating a flood of requests from other member countries demanding changes. India and Venezuela, for example, also have urged a reconfiguration of the Security Council to conform to contemporary global conditions and to give greater representation to developing countries. Japan's critics also point to the fact that Germany, which also remains labeled an "enemy state," has not pushed for a permanent seat on the Security Council.

Rather than lighting the fuse on this issue, the Foreign Ministry has proposed respecting the interests of the five permanent members for the time being. Japanese diplomats feel that the country would have equal, if not better, opportunities to demonstrate global leadership by working cooperatively with other major powers within the current framework. In this regard Tokyo also has backed off its request that the two "enemy state" clauses be deleted. Foreign policy professionals are concerned that action here also risks opening a Pandora's box of other countries' demands for charter changes. This group obviously would prefer to have this outdated stigma removed — but not at any cost.

Being the major ministry involved with U.N. affairs, however, the Foreign Ministry naturally has among its ranks those who believe that the current Security Council arrangement amounts, for Japan, to "taxation without representation." Japan's assessed U.N. budget share was 11.38 percent in 1991, second only to that of the United States (25 percent) and only slightly less than the combined shares of France (6.25 percent), Great Britain (4.86 percent) and China (0.79 percent) (see Tables 1-3). Diplomats who favor more equity in this arrangement contend that Japan should have a stronger say on budget and operational issues.

Table 1: **Status of Selected Members' Contributions to the United Nations' Regular Budget, 1991**

(in dollars)

	Scale of Assessments	Assessed Collections*	Contributions Outstanding		
			Prior Years	Current Year	Total
United States	25.00	$301,326,450	$0	$266,407,875	$266,407,875
Japan	11.38	104,844,802	0	0	0
Soviet Union**	9.99	48,659,792	0	46,019,313	46,019,313
Germany	9.36	86,234,398	0	0	0
France	6.25	57,581,723	0	0	0
Great Britain	4.86	44,775,548	0	0	0
Italy	3.99	36,760,172	0	0	0
Canada	3.09	28,514,721	0	0	0
People's Republic of China	0.79	7,278,329	0	0	0
Other Countries	25.29	210,307,138	64,304,798	62,651,959	126,956,757
Total	100.00	926,283,073	64,304,798	375,079,147	439,383,945

*Does not include voluntary contributions.
**Does not include contributions by Belarus and Ukraine.

Source: United Nations Secretariat

Table 2: **Selected Members' Contributions to the United Nations' Regular Budget, 1992**

(in dollars)

	Scale of Assessments 1992-94	Proposed Net Contributions*
United States	25.00	$298,619,001
Japan	12.45	122,609,322
Soviet Union**	9.41	92,670,982
Germany	8.93	87,943,875
France	6.00	59,088,830
Great Britain	5.02	49,437,654
Italy	4.29	42,248,513
Canada	3.11	30,662,414
People's Republic of China	0.77	7,583,066
Other Countries	25.02	246,607,939
Total	100.00	1,037,471,596

*Does not include voluntary contributions.
**Does not include contributions by Belarus and Ukraine.

Source: United Nations Secretariat

Table 3: **Selected Members' Contributions to the United Nations, 1989-90**

(in thousands of dollars)

	1989		1990	
	Assessed	Voluntary	Assessed	Voluntary
United States	$457,080.8	$522,833.2	$716,275.7	$555,794.4
Japan	255,121.0	514,194.6	309,411.0	392,175.1
Soviet Union*	317,038.2	6,624.8	0.0	4,378.8
Germany**	261,201.2	180,699.5	225,280.1	210,532.3
France	184,944.6	87,400.9	168,218.7	102,276.9
Great Britain	134,711.4	163,690.9	115,741.5	164,506.5
Italy	107,883.7	249,146.6	92,461.2	173,847.2
Canada	83,307.6	152,898.8	78,994.0	110,915.6
People's Republic of China	25,221.5	9,403.2	23,772.9	10,811.1
Other Countries	621,199.0	1,335,101.1	877,350.1	1,728,771.3
Total	2,447,709.0	3,221,993.6	2,607,505.2	3,454,009.2

*Does not include contributions by Belarus and Ukraine.
**Combined total for East Germany and West Germany.

Note: Assessed Contributions - Contributions to the regular budget of the United Nations, the Committee on the Elimination of Racial Discrimination (CERD), the International Convention Against Apartheid in Sports, the U.N. Emergency Force, including the U.N. Disengagement Observer Force (UNEF, including UNDOF), the U.N. Interim Force in Lebanon (UNIFIL), the U.N. Iran-Iraq Military Observer Group (UNIIMOG), the U.N. Angola Verification Mission (UNAVEM), the U.N. Transition Assistance Group (UNTAG), the U.N. Observer Group in Central America (ONUCA), the International Labor Organization (ILO), the Food and Agriculture Organization of the U.N. (FAO), the U.N. Educational, Scientific and Cultural Organization (UNESCO), the International Civil Aviation Organization (ICAO), the World Health Organization (WHO), the Universal Postal Union (UPU), the International Telecommunication Union (ITU), the World Meteorological Organization (WMO), the International Maritime Organization (IMO), the World Intellectual Property Organization (WIPO), the International Atomic Energy Agency (IAEA) and the U.N. Industrial Development Organization (UNIDO).

Voluntary Contributions - Contributions to U.N. trust funds, the U.N. Peacekeeping Force in Cyprus (UNFICYP), the U.N. Industrial Development Organization (UNIDO), the U.N. Environment Program (UNEP), the U.N. Center for Human Settlements (UNCHS), the U.N. Children's Fund (UNICEF), the U.N. Development Program (UNDP), UNDP-administered trust funds, the World Food Program (WFP), the Office of the U.N. High Commissioner for Refugees (UNHCR), the U.N. Relief and Works Agency for Palestine Refugees in the Near East (UNRWA), the U.N. Institute for Training and Research (UNITAR), the U.N. Population Fund (UNFPA), ILO, UNESCO, WHO, UPU, IMO, WMO, WIPO, IAEA and ICAO.

Source: U.N. Committee on Contributions

Die-Hard Pacifism - What ultimately may continue to limit Japan's ability to play a more meaningful role in the United Nations — as a permanent Security Council member or not — are the views of the Japanese public. The pacifist sentiments that flourished in Japan following World War II remain quite strong. Pacifism, in fact, is the rationale most often cited for the aversion among many Japanese to extensive overseas engagements, either military or political. As a result, the Japanese public has bridled whenever struck by the perception that policymakers are pushing the country too far, too fast in the foreign policy area. Some observers contend that this lingering popular resistance to a more active, high-profile diplomacy is all the more reason for Japan to pursue expanded global responsibilities in a gradual manner within the context of the United Nations.

A prime indicator of the extent to which public opinion has helped to thwart Tokyo's efforts to play a more engaged role in world affairs is the U.N. peace cooperation bill. This proposal would authorize Japanese military personnel to participate in United Nations-sponsored peacekeeping activities. Members of the political opposition have portrayed the measure as stretching too far the 40-odd-year interpretation of Japan's "peace constitution," which bars the dispatch overseas of Japanese military personnel to engage in collective defense arrangements. The general esteem given this clause of the constitution makes the opposition parties' cooperation in passing the bill important; without their imprimatur the ruling Liberal Democratic Party senses that the proposal would strike a raw nerve in World War II-era Japanese fearful of resurgent militarism. Although as proposed the legislation would limit dispatches strictly to U.N.-sponsored peacekeeping missions — not unlike those in the Middle East and elsewhere to which Japanese civilians already have lent their support — the government still finds too little backing and twice has withdrawn the bill from the Diet.

Despite the many different revisions to make the peacekeeping support bill enactable, its prospects for passage still appear dismal. Japanese foreign policy professionals, in particular, have been pressing for expeditious consideration of this legislation because it would give Japan authority to make important new contributions to safeguarding peace. Specifically, the U.N. Transitional Authority in Cambodia, which recently was authorized by the Security Council, would provide Japan with an important opportunity to demonstrate its willingness to assume more leadership responsibility in the region. Tokyo originally planned to send peacekeeping troops to UNTAC, but without passage of the peacekeeping bill it is limited to contributing civilian personnel to help monitor the war-torn country's elections and perform other nonmilitary peacekeeping activities (see *JEI Report*, No. 6B, February 14, 1992).

Foreign Minister Michio Watanabe has scrambled to try to develop a compromise measure that would pass the Diet. However, even his watered-down alternative, which would render inactive any provisions that authorize the participation of Japanese military personnel in "riskier" U.N. peacekeeping activities, may fail because it is considered too weak by the LDP and too bold by the opposition parties (see *JEI Report* No. 8B, February 28, 1992). Since Mr. Miyazawa promised participants at the Security Council summit that he would do his utmost to shepherd this legislation through the Diet, a third setback will make Japan — as well as the prime minister — vulnerable to allied criticism that the country does not know how to behave like a world-class power.

Other Potential Constraints to an Expanded U.N. Role

Even with the development of a coherent, politically acceptable policy on Japan's role in the United Nations, Tokyo's effectiveness within the multilateral organization may be limited by personnel and staffing problems. If a country is to have an impact at all on policy development within the United Nations, it needs a cadre of foreign policy professionals specifically trained in the complexities of U.N. operations. For almost as long as Japan has been a U.N. member it has been underrepresented in terms of professional staff, which generally has numbered around 100 people — about half of what the secretariat regards as optimum.

Some observers maintain that this deficit has limited Tokyo's ability to become involved in a major way on the wide range of U.N. policy, programmatic and organizational matters. Several reasons explain why Japan's assigned personnel slots for the United Nations are not proportional to its level of financial support for the organization (see *JEI Report* No. 7A, February 22, 1991). One reason given by the Foreign Ministry is that Japan missed out on the initial allocation of responsibilities. Foreign Ministry sources add that the generally uncompetitive salary/benefits package for a U.N. posting also makes it hard for the government to attract good Japanese applicants. (Even when exchange and salary rates benefited the Japanese in years past, however, there was a shortfall in Japanese staffing.) In addition, since about half of the country's U.N. appointees come from the Foreign Ministry or other government agencies, the turnover of Japanese personnel tends to be unusually high as the bureaucrats usually stay for only two- or four-year tours before being sent back to Tokyo or given another overseas assignment. Observers say that if Tokyo wants to play more of a leadership role in the United Nations in the years to come, the Japanese government may find it beneficial to revise its posting practices and find ways to attract and keep more qualified staff; these people then could provide more support for higher-profile U.N. activities. The Japanese government's current priorities, however, do not appear aimed at addressing the bureaucratic needs associated with a more active diplomacy (see *JEI Report* No. 3A, January 24, 1992).

Some analysts also have expressed concern that Japan's deliberative, consensus-oriented policymaking style may inhibit the country's ability to act decisively within the United Nations, particularly in the event of another crisis comparable to the one created by Iraq's aggression against Kuwait. Foreign policy professionals and others suggest, however, that Tokyo's "marching orders" to its U.N. delegation will not limit Japan's participation in important policy debates. Columbia University's Immerman has observed that Tokyo's U.N. activities are not as politicized or as entwined in an intragovernmental web as Washington's initiatives; in some ways, he adds, the Japanese delegation may enjoy comparatively more flexibility than its American counterpart.[4]

The Japanese government's tendency to become distracted in the pursuit of various diplomatic goals by domestic political problems also concerns those Japanese and allied observers who are anxious to see Japan move toward global center stage. The Foreign Ministry's most recent attempt to salvage the U.N. peacekeeping support bill, for example, has been complicated by the Diet's preoccupation with two political scandals — one involving a former close associate of Mr. Miyazawa and possible other high-ranking LDP members and the other possibly embroiling members of the ruling LDP and the opposition parties. Until and unless the government can reform the electoral system (see *JEI Report* No. 9B, March 6, 1992), domestic political turmoil no doubt will continue to interfere with the evolution of Japanese diplomacy.

Outlook: A Good 'Second Man'

Tokyo may feel overwhelmed by the sometimes conflicting forces that affect deliberation of its role in the United Nations and, what is more important, its conceptualization of Japan's overriding diplomatic mission in the new world order. Since the former policymaking task really cannot be broached effectively without undertaking the more difficult latter examination, Foreign Ministry officials suggest that such issues as a permanent Security Council seat probably will be relegated to the back burner for quite some time.

Within the Japanese government, however, there is a broad base of support for using the United Nations as a forum in which to demonstrate Japan's ability to make important, nonmilitary contributions to help rectify the entire gamut of political, economic, scientific, environmental and other problems affecting the world. In one Japanese observer's words, Tokyo wants to accumulate a record of concrete achievements within this multilateral organization and, in effect, resume a gradual expansion of Japanese involvement in global economic and political policymaking — a movement that appears to have been derailed by the gulf crisis.

Foreign Ministry officials also emphasize that Japan does not regard a higher-profile role in the United Nations as a challenge to U.S. leadership or as an indication that Tokyo will pursue increasingly independent policy actions. While Tokyo may strike out on its own on issues pertaining to Asia, Japanese foreign policy professionals stress that the Japanese government is committed to implementing the partnership precepts of the Tokyo Declaration concluded by President Bush and Mr. Miyazawa in January (see *JEI Report* No. 2B, January 17, 1992). Japan hopes to play an "enlightened role," one that complements U.S. leadership, they say. These observers stress that Japan's U.N. role will be that of a "good 'second man'," willing to cooperate and coordinate with the United States according to each country's areas of strength.

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Notes

[1] Paper presented by Robert Immerman, East Asian Institute, Columbia University, to the Woodrow Wilson Center conference "Japan and the World," Washington, D.C., January 27-28, 1992.

[2] *Ibid.*

[3] Robert Immerman, Senior Research Associate, East Asian Institute, Columbia University, telephone interview, March 2, 1992.

[4] *Ibid.*

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JEI

REPORT

A Two-Part Report: A and B

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Private Forecasters Pessimistic About FY 1992 Japanese Economy

Japan's private-sector business forecasters sometimes are accused of being excessively influenced by the government outlook in making predictions about the economy's performance for the coming fiscal year, but the accusations look hollow this year. In contrast to their government counterparts, who expect the nation's inflation-adjusted gross national product to grow 3.5 percent in the fiscal year that begins April 1 (following an estimated 3.7 percent real expansion in FY 1991), private-sector economists predict that growth will average a mere 3 percent in FY 1992 (see Table). This projected rate compares to the 3.5 percent gain estimated by the same forecasters for FY 1991. (For details of the government outlook, released in late December, see *JEI Report* No. 1B, January 10, 1992.) If the private consensus proves correct, growth in FY 1992 will exceed only slightly that in the FY 1986 recession year, when the economy grew 2.9 percent, its worst showing since FY 1974.

Only one forecaster, the perennially optimistic Research Institute of the National Economy, is more sanguine about the economy in FY 1992 than is the government. Its expectation that real GNP will expand 4 percent in the coming fiscal year is at least half a percentage point higher than any of the other 38 private-sector forecasters surveyed. Most pessimistic are the respected Nomura Research Institute and Dai-Ichi Kangyo Bank, Ltd., both of which believe the economy will grow only 2.3 percent after adjustment for inflation in FY 1992.

The forecasts by Nomura and the Research Institute of the National Economy are notable in at least one other respect. Despite their opposite stance on the buoyancy of the overall economy, they both predict that the external sector will boost growth significantly in FY 1992. They envision an

Summary of Private Forecasts for FY 1992

(percent change unless otherwise indicated)

	Real GNP		Real Consumer Spending	Real Capital Spending	Consumer Prices	Current Account Surplus*	¥/$ Exchange Rate	Oil Prices ($/barrel)
	FY 1991	FY 1992						
Banks								
Sumitomo Trust & Banking Co., Ltd.	3.6%	3.4%	3.5%	4.0%	2.1%	$68.4	¥135.0	$19.8
Bank of Tokyo, Ltd.	3.6	3.2	3.6	4.0	1.9	73.2	127.0	20.8
Bank of Yokohama, Ltd.	3.6	3.1	3.5	2.4	2.1	91.7	128.0	28.3
Kyowa Saitama Bank, Ltd.	3.6	3.1	3.2	2.2	2.0	72.6	129.3	18.5
Mitsubishi Trust & Banking Corp.	3.6	3.1	3.1	3.0	2.7	76.0	129.0	21.0
Fuji Bank, Ltd.	3.5	3.0	2.8	2.8	2.0	70.0	135.0	21.3
Mitsubishi Bank, Ltd.	3.5	3.0	2.8	4.1	2.5	64.4	125.0	21.4
Mitsui Trust & Banking Co., Ltd.	3.5	3.0	3.0	3.1	2.4	75.7	127.4	20.0
Yasuda Trust & Banking Co., Ltd.	3.4	2.9	3.1	2.5	2.2	76.5	130.4	19.3
Daiwa Bank, Ltd.	3.3	2.8	2.9	3.8	2.6	80.1	128.0	18.0
Nippon Credit Bank, Ltd.	3.5	2.8	2.9	2.9	2.3	74.5	133.0	20.3
Tokai Bank, Ltd.	3.1	2.8	3.3	2.8	2.0	60.8	120.0	20.0
Industrial Bank of Japan, Ltd.	3.6	2.7	2.9	1.9	2.1	76.1	131.0	18.0
Toyo Trust & Banking Co., Ltd.	3.5	2.7	3.2	2.3	2.1	70.7	126.0	20.0
Chuo Trust & Banking Co., Ltd.	3.2	2.6	3.2	2.9	2.2	65.0	131.3	18.5
Hokkaido Takushoku Bank, Ltd.	3.6	2.6	3.4	2.0	2.0	79.9	129.4	18.1
Sumitomo Bank, Ltd.	3.7	2.6	3.2	1.4	2.0	74.4	130.0	19.5
Dai-Ichi Kangyo Bank, Ltd.	3.3	2.3	2.7	-0.1	2.2	84.0	130.3	19.5
Insurance Companies								
Meiji Mutual Life Insurance Co.	3.6	3.2	2.9	2.9	2.4	79.1	127.5	19.5
Sumitomo Life Insurance Co.	3.5	3.1	3.2	2.8	2.5	75.0	130.0	20.0
Tokio Marine & Fire Insurance Co., Ltd.	3.5	2.9	3.0	1.5	2.5	73.0	130.0	19.0
Asahi Mutual Life Insurance Co.	3.3	2.8	3.2	1.7	2.1	78.6	132.8	19.2
Dai-Ichi Mutual Life Insurance Co.	3.5	2.5	2.9	0.2	2.1	80.2	130.0	18.0
Trading Companies								
Marubeni Corp.	3.5	3.3	3.1	3.6	3.0	66.8	132.0	20.0
Mitsubishi Corp.	3.7	3.0	3.6	3.4	2.1	70.0	128.0	20.2
Sumitomo Corp.	3.4	2.6	3.2	0.8	1.8	74.9	130.0	19.0
Research Organizations								
Research Institute of the National Economy	3.7	4.0	3.8	5.2	2.2	67.8	126.5	19.0
Kansai Economic Research Center	3.6	3.5	3.7	6.0	2.4	63.0	128.1	22.5
Cosmo Securities Economic Research Institute	3.5	3.3	3.1	2.9	2.1	86.4	131.8	20.0
Japan Economic Research Center	3.7	3.2	3.2	2.2	2.1	105.5	121.0	19.3
Sanyo Research Institute	3.4	3.2	3.0	3.1	2.3	64.1	125.0	19.5
Daiwa Institute of Research	3.8	3.1	3.2	3.3	1.9	76.4	126.5	20.0
Kangyo Kakumaru Research Institute	3.4	3.1	3.7	0.4	2.5	78.4	133.0	19.3
Yamaichi Research Institute	3.5	3.1	3.2	1.8	2.2	80.5	130.0	19.0
Mitsui Taiyo Kobe Research Institute	3.8	3.0	3.1	3.3	2.1	82.9	125.0	19.0
Okasan Economic Research Institute	3.5	2.9	2.8	1.9	2.3	77.2	127.5	18.1
Mitsubishi Research Institute	3.2	2.7	3.7	1.6	1.2	86.4	120.0	20.8
Nikko Research Center	3.3	2.7	2.9	-0.4	2.2	76.9	125.0	20.0
Nomura Research Institute	3.4	2.3	2.8	-1.0	2.5	87.4	138.0	17.0
Average Forecast	**3.5**	**3.0**	**3.2**	**2.4**	**2.2**	**76.0**	**128.8**	**19.8**

*In billions of dollars.

Source: *Toyo Keizai Tokei Geppo*

expansion of net exports that will add between 0.7 and 0.8 percentage point to GNP growth. If these strange bedfellows are correct in their view that exports will increase faster than imports, then Washington once again can expect little in the way of net macroeconomic stimulus to the U.S. economy from Japanese economic growth.

Not surprisingly, considering the relationship between overall external and internal growth, Nomura also weighs in with an estimate of an anemic 1.6 percent rise in Japanese domestic demand over the next 12 months. In contrast, government economists expect the external sector to trim overall growth by 0.1 point, but they see domestic demand boosting the economy by 3.6 points. The overall private forecast differs from both Nomura's and the government's, projecting that net exports will add 0.1 point to the economy's expansion and that domestic demand will contribute 2.9 points.

Nomura's low figure for the expected rise in domestic demand reflects another important difference among the forecasts. Among all 39 private-sector estimates its prediction of a 1 percent drop in real nonresidential private capital spending — which comprised 22 percent of GNP in the most recent quarter for which data are available — is the most pessimistic. The only other forecasters expecting a decline in plant and equipment outlays in the next fiscal year are Dai-Ichi Kangyo Bank, which is as gloomy regarding the overall economy as Nomura, and Nikko Research Center. By contrast, the government and the Research Institute of the National Economy, which are the most optimistic overall, also have the most favorable expectations concerning plant and equipment spending, predicting 4.5 percent and 5.2 percent growth, respectively.

In short, business investment appears to hold the key as to whether or not Japan's economy merely slows down in FY 1992 or turns in one of its worst performances in Japan's postwar history. Firms have continued to scale back their investment plans in the months since most of the forecasts summarized in the Table were released. As a result, economists recently have become, if anything, more pessimistic about the overall economy. Although Japan's GNP is unlikely to actually shrink in FY 1992 as the U.S. economy did in 1991, growth rates in the 3 percent range or even lower in both FY 1991 and FY 1992 would represent a dramatic slowdown from the numbers turned in by the Japanese economy in the FY 1987-FY 1990 period, when real growth averaged 5.3 percent a year.

Douglas Ostrom

Cabinet Seeks To Spur Japanese Economy

As signs accumulate that Japan's economy is sliding more deeply and more quickly into a recession than forecast by government and business analysts, the government of Prime Minister Kiichi Miyazawa quickly has assembled a package of short- and medium-term measures to stimulate the economy. Although the steps have been welcomed by most Japanese observers, they question whether the spate of political influence-peddling scandals dogging the ruling Liberal Democratic Party may delay enactment of the needed fiscal measures.

Despite three discount rate cuts by the Bank of Japan over the past nine months, the Japanese economy continues to slow under the weight of rising inventories, reduced manufacturing activity, cutbacks in private capital investment and weak export markets. Furthermore, analysts now are worried that consumer spending, the one remaining bright spot in the domestic economic picture, is beginning to weaken. Concern also remains strong that the continuing slump in domestic equity markets — despite the discount rate cuts and other support measures — could end in collapse and add to the economy's burdens.

In the face of this gloom the Miyazawa government has turned to the standard tools of fiscal stimulation. At a March 6 meeting the cabinet directed the government to take the following immediate actions:

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JAPAN · ECONOMIC · INSTITUTE

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REPORT

A Two-Part Report: A and B

NO. 11A

March 20, 1992

JAPAN'S ECONOMY: A TRANSFORMATION?

SUMMARY

Many of the characteristics that have qualified Japan's economic performance as an "economic miracle" are now in the midst of a transformation that is moving Japan from its outlier position among the advanced economies to a more regular member of the league. The nation's high rates of saving, investment, productivity increase and — above all — economic growth are declining. In addition, a shrinking labor force implies a higher relative growth of wages and a shift of national income to labor. Drawing implications on how these separate strands might influence future developments — particularly in Japan's economic and political roles in the world and its relations with the United States — is a speculative venture, subject to a variety of domestic realignments that could disrupt the predictions and confound the analysis.

Japan's Economic Miracle

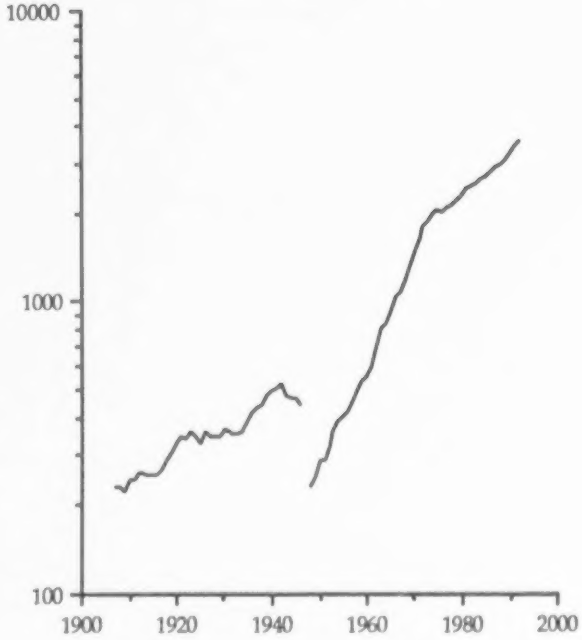
Japan's postwar economic development occurred in two distinct phases, with 1970 marking the approximate dividing line. From 1946 to 1970 Japan's economy grew very rapidly, experiencing a peak period between 1953 and 1969 (see Figure). Inflation-adjusted gross national product per capita expanded 8.9 percent per year from 1946 to 1970, while for the subperiod growth averaged an astounding 9.2 percent. After the oil crisis in 1973 Japan entered a new phase in which per capita growth slowed to 3.3 percent annually for the years through 1990. Because of the structural changes now occurring, a new phase of even slower growth over the next decade or more is highly likely.

Aggregate economic growth flows from two main sources: the expansion of inputs, such as capital and labor, and the growth of productivity in using those inputs. According to one review of the factors contributing to Japan's 8.3 percent average annual real GNP growth rate from 1960 to 1979, the increase of capital inputs accounted for about 5 percentage points, labor added a further 1.5 points and productivity improvements chipped in nearly 2 points.[1] The postwar economic surge in Japan was marked by a virtuous circle of mutually reinforcing, growth-promoting behavior — some of which was encouraged by government policy. Very high domestic household savings, for example, were channeled to industry through a controlled and regulated financial system. In turn, industry invested its own funds plus household savings in new plant and equipment that embodied up-to-date technology. The swift growth of the stock of modern capital in an economy that lagged world productivity leaders led to rapid productivity improvements. Completing the circle, the enormous investments in more productive capital acted with a growing and better educated work force to generate the economic growth rates shown in the figure.

Government policy and laws encouraged savings, restricted the outflow of capital and tied domestic savings to domestic investment. Other regulations during that high-growth period protected many Japanese industries from the competition of more efficient foreign producers. Why did protection in Japan promote efficiency and productivity when in so many other countries similar policies resulted in monopolized markets and loss of competitiveness? Protection in Japan allowed companies in some industries, such as automotive manufacturers, to expand capacity or enter new markets with sometimes wild abandon because they had ready access to capital via the regulated financial markets. For example, the 1953 imposition of protective barriers in the motor vehicle market had attracted the entry of 11 companies by the end of the decade. Despite the government's interest in whittling down the competition in this industry, these companies fought for a total annual market that in 1955 was equivalent to one day's output of the U.S. automotive industry. Fierce domestic competition in cars and trucks and in many other industries stimulated production innovations and efficiencies that continue to have echoes worldwide.

Japan's GNP Per Capita in 1985 Prices

(in thousands of yen)



Note: A break in the data occurs in the first postwar year of 1946.

Source: For 1905-70 period Kazushi Ohkawa and Henry Rosovsky, *Japanese Economic Growth* (Stanford, California: Stanford University Press, 1973), pp. 280-281. For 1971-90 period Management and Coordination Agency, Statistics Bureau, *Japan Statistical Yearbook*, various years.

Japanese government policy had mixed effects on economic growth. Some of these effects were unintended — for example, the fierce, "excessive," efficiency-generating competition, which resulted from the easy access to capital enjoyed by certain industries. In other cases, policy was ignored, as illustrated by the automobile industry's dismissal of government guidance. In still other cases, government imposed costs on business and society through its regulation of such service sectors as transportation and communication. At this stage of knowledge, the net effect of government on Japanese economic development must remain a question.

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Most of the elements of the virtuous circle making up the Japanese miracle now are responding to new forces in Japanese society and to pressures from Japan's foreign partners and competitors. As these underlying factors undergo change, the country will embark on a new growth path, established by the transformation of savings, labor supply, investment and productivity growth in Japan (see *JEI Report* No. 4A, January 31, 1992, and *JEI Report* No. 37A, October 4, 1991).

Household Savings

The savings of Japanese households have been a primary engine driving the spectacular growth of the post-World War II Japanese economy. The ratio of household savings to disposable income has been among the highest in the industrial world; only Italy has outpaced Japan in selected years. From 1965 to 1974, for example, Japanese saved 17.9 percent of their disposable income; the comparable figure for the United States was 7.8 percent.[2] Adjustments to Japanese and American data to correct for differences in definition and for conceptual shortcomings reduce the gap between the two countries by about 4 to 5 percentage points.[3] In the single year of 1974 Japan's households saved almost one-quarter of their disposable incomes. That year, however, marked the high point of the postwar era. Since then the overall trend has been steadily downward, sinking to 18 percent in 1980, 16 percent by the middle of the decade and 14 percent by 1990. Most economic forces continue to push household savings rates lower, with few factors working in the other direction.

Demographics - Retired people in general save less than younger, working-age people, and the proportion of the Japanese population that is elderly is growing. Cross-national analyses on the whole find strong evidence for the effects of age on the savings rate, typically showing that the ratio of the population aged 65 and over to the working-age segment of 20- to 64-year-olds has a significant negative impact on the household savings rate. Such an impact usually is harder to discern in a single country's experience. Several studies indicate, however, that Japan's relatively young population in the 1970s accounted for 4 to 7 percentage points of the difference in the savings rate between Japan and the average experience of the developed nations belonging to the Organization for Economic Cooperation and Development.[4] Since the population replacement rate is dropping in Japan, the number in the prime working-age group will begin to decline because more people will reach retirement age than will enter the work force. Many analysts predict that this demographic trend will push down future Japanese savings rates. Others dispute the strength of this effect, noting that retired Japanese continue to save, although at a lower rate than in their wage-earning years.

Slower Economic Growth - Rapid economic growth is strongly associated with higher savings in studies based on cross-national experience. One study by the Massachusetts Institute of Technology's Franco Modigliani and Arlie Sterling found that the high rate of Japan's per capita income growth was by far the most important cause of the nation's high private savings rate. They estimated that per capita income growth yielded an 11 percentage point difference between Japan's rate and the average for the other sample countries.[5] Statistical evidence based on a single country's behavior over time has produced mixed results at the detailed level but generally indicates that a high growth rate produces a high savings rate. As noted above, Japan's real annual GNP per capita growth rate has fallen steadily from its 1953-69 peak rate; all indications are that aggregate economic growth will continue to slow. (This will be discussed in more detail below.) Although the specific mechanisms through which income growth influences household savings still are not clear, the sharp downward trend in Japan's economic growth foretells a powerful depressing effect on savings.

Share of Self-Employed Workers - Throughout the first decade of the postwar period the share of income generated by self-employed workers in Japan was quite high by international standards. In 1955 private unincorporated entrepreneurs earned 37 percent of national income. The savings rate of the self-employed generally is higher than that of any other group, primarily because of greater income fluctuations and the need to save for business downturns, illness and retirement. Over the years, though, the self-employed population's share of national income in Japan declined steadily as more workers were absorbed into the corporate business sector. By 1975 the share had fallen to 17 percent; in 1988 it was 10 percent. The number of self-employed and their share of national income will continue to decline in step with the steadily widening gap between the income of employees and the self-employed — a gap that has grown since the late 1970s and that in consequence has diminished the incentive to go into business for one's self.[6] There is no indication of a future shift out of the salaried employees' ranks that could raise the savings rate.

Other Influences on Savings - Use of consumer credit has spread rapidly in Japan since the late 1970s; outstanding amounts of consumer credit in the household sector grew from 6.7 percent of disposable income in 1976 to 15 percent in 1987. Projections of credit use indicate that Japanese levels could approach American values by 1995.[7] The significance of the increased use of credit is not only that savings are depressed during the credit growth period because credit substitutes for savings but that credit can be used for emergencies and other unplanned expenditures, thereby reducing the need for precautionary savings.

The central government also has removed several tax breaks for savings that were prevalent through the 1980s. Interest income from bank deposits, bonds and other investments, for example, was exempt from income tax. Additionally, interest from postal savings accounts and from national and local government bonds also was tax-exempt.[8] Interest on deposits up to ¥5 million ($37,000 at ¥135=$1.00) in Employee Property Formation Accounts also was exempt. Taking the various exemptions into account, each individual was eligible for tax exemptions on interest income of ¥14,500,000 ($107,400). In addition, other types of returns from personal savings efforts, such as capital gains on land, housing and equities, were largely tax-free.[9] Moreover, unlike in the United States, Japanese consumers received no tax breaks for borrowing; interest paid on mortgages and consumer loans was not tax-deductible. In 1988, however, most of the tax breaks on savings were abolished; capital gains, however, continues to receive favorable tax treatment, although reduced from past levels. Pressures from abroad now are aimed at reducing these tax advantages even further, with the express purpose of boosting consumption in Japan.

Japan's public pension system, which was quite weak through 1973, has been upgraded substantially since then and now is comparable to systems in other developed countries. Inadequate public pensions typically induce private savings to meet retirement needs. Even when a new public scheme is introduced, a generation usually passes before participants feel confident in the system and change their savings behavior. The current generation in Japan now appears to be relying on the public system for a good share of its retirement benefits. Analysis by the OECD indicates that public pension benefits have had a significant, increasingly depressive, effect on Japanese savings since 1973. This effect has been greatest for those with the longest history in the system and, therefore, is likely to grow in the future.[10]

Finally, most observers of Japanese society note that the generation now in its 20s is more consumption-oriented than the previous generation. These younger people certainly are greater users of credit and can be seen thronging department stores and airline counters. The balance of individual debt for the under-24-year-old segment of the population increased more than fourfold between 1988 and 1990; members of the younger generation are credited with being the biggest users of credit cards.[11] Abetting this apparent change in attitudes is a slow reduction in annual working hours; present government and business policy promotes an accelerated timetable to reduce working hours to 1,800 a year. Increased leisure time would be a complement to higher consumption and reduced savings.

All the forces outlined above are pushing the household savings rate down. The Economic Planning Agency has projected a household savings rate of 11.5 percent by the end of the decade — a level that would bring Japan into line with European experience but still be substantially above the U.S. rate. By the year 2010 the government has forecast a level of 9 percent; private economists think that it could be even lower.[12]

Declining Labor Force

As mentioned above, the proportion of older Japanese in the population is growing. As a consequence, the number of people in the so-called productive age group of 15 to 64 will begin to decline in 1995; within 10 years that slice of the population is projected to be about 4 percent below the 1994 peak.[13] This decline is comprised of two parts: the number of people entering the labor force and the number retiring. The number of 20-year-olds, for example, will cease growing and actually decline in 1994; by the year 2000 their absolute number will be smaller than in 1950 in a total population that will be 60 percent larger. On the other side of the population distribution curve the number of people over 65 has been increasing for several decades; the 1989 percentage of those over 65 in the total population was 11.4 percent — double the 1960 ratio. By the year 2000 this proportion will increase to 17 percent. Thus, the working-age population is being squeezed at both ends.

Greater labor force participation can alleviate some of these declines. Female workers, in particular, have contributed the bulk of the labor force growth since 1975, with rates of increase double those of males — 4.9 percent versus 2 percent in 1990, for example.[14] The Japanese female labor force participation rate of 50.1 percent in 1990 was a shade under the U.S. figure of 52.5 percent. The major difference between American and Japanese female labor force participation occurs in the child-bearing years. According to surveys, a large number of these Japanese women wish to work but are unable to do so because of a lack of day-care facilities and sufficiently generous maternity leave.

The total male labor force participation rate is higher in Japan at 77 percent than the comparable American figure of 71.5 percent. If the American male work experience is used as a guide to possible Japanese trends, there appears to be little expansion capacity in Japanese male labor force participation. The Japanese economy, therefore, will face an absolutely declining number of workers unless major policy changes induce a substantial move by women into the labor force to compensate for the falling number of potential workers caused by the shrinking birth rate and the aging of the population.

Financial Market Deregulation and Globalization

Until the mid-1970s Japan's financial sector was regulated extensively. Rigid rules confined financial institutions to specific functions and specialized services. Interest rates, too, were strictly regulated, and tight controls restricted international capital movements. Moreover, competition among and within financial subsectors was controlled closely. This structure prevented firms from being exposed to the market cost of capital; their investment decisions often seemed to bear little relation to an underlying economic rationale. It was under this financial regime that the economywide capital-labor ratio tripled from 1960 to 1970 and doubled again in the next 10 years.[15]

This regulated structure began to crumble in the mid-1970s as economic, political and international pressures made the old system too costly to continue. These pressures included: the sharp rise in Japanese government debt (which could not be marketed under the tightly controlled existing regime), the breakdown in the Bretton Woods fixed exchange rate system and the rapid involvement of Japan in the world trading system. As one barrier after another was removed, market forces created new pressures for still greater deregulation. Negotiations with the United States in 1984 on financial deregulation added more stimulus for change. By the mid-1980s greater international competition in financial services — abetted in part by advances in telecommunications and computing technology — increased the need for freer and more flexible financial markets.[16]

Although many controls still remain, by and large Japanese companies now confront a market cost of capital. More than that, to a large extent the cost is determined globally. There is little or no advantage to a Tokyo, London or Minneapolis firm, for example, in raising short-term yen in one or another world market. Long-term corporate markets, though, still seem to be somewhat segmented and defined by national boundaries — a point that will be addressed later.

Deregulation of Other Markets

In addition to financial markets, several other hitherto controlled and regulated sectors of Japan's economy are in the process of liberalization. Telecommunications services, air transport and rail transport have been privatized, demonopolized and opened to price competition and new market entrants. Restrictions on large-scale retail trade are being relaxed. Government agencies are scrutinizing more carefully bid-rigging and cartels in construction. Agricultural sectors, such as oranges, now are facing international competition after a long protected history. These changes come about 20 years after businesses in most industries had adjusted to the removal of the protective umbrellas from their products.

This series of openings and liberalizations largely arose from domestic economic and political forces. In brief, more benefits usually accompanied deregulation than would be lost from disrupting the status quo — generally, much more. Businesses in the competitive, trade-oriented industries, in particular, were burdened by the high-cost, inefficient regulated sectors on which they had to depend for supplies and services. Those Japanese politicians who recognized the potential gains to constituents supported the transitions while seeking the necessary political exchange to satisfy the inevitable losers. Although the process often required years of perseverance against other political groups, bureaucratic interests and formerly protected parties that benefited from the status quo, the past 20-year period has seen a steady dismantling of controls. Foreign pressures often helped to push or steer these bandwagons, but without domestic support foreigners would have made little headway on their own.[17]

Since many trade barriers ultimately rest on some regulatory foundation, the gradual liberalization of the domestic economy has had international repercussions. It is difficult today to find a single example of higher barriers (formal or informal) to international trade than existed in the past. Although many barriers remain, the cumulative effects of these deregulations have been to make Japanese markets more open and more competitive for both domestic and foreign firms.

The End of Productivity Catch-Up

In recent years economic researchers have tried to explain the newly discovered phenomenon of productivity catch-up, whereby countries that lag behind the leading countries' productivity levels exhibit growth rates in productivity proportional to their relative backwardness. Since 1945 a remarkable convergence has occurred in the economywide productivity levels of the industrialized economies. In 1950, for example, Japan's productivity was only one-fifth of the most advanced country — the United States. By 1979 Japan's productivity had zoomed to a level only 27 percent below America's.[18]

Just being behind, however, does not guarantee the benefits of automatic growth. Several preconditions appear to be necessary: economic and political stability, international product and technology flows, and an efficient domestic market. Given these conditions, the most important means by which world-class product technology and production methods are introduced into an economy is through investment. All the necessary conditions were present in Japan in the post-World War II period — especially the rapid rate of investment, which had a multiplicative effect on the simple advantage of being a laggard. Because of the very rapid growth of the capital stock, the average age of Japan's capital was an estimated youthful 10 years in 1979, compared to 17.3 years in the United States. Relatively young capital, on average, incorporates more recent technology and is more productive than older capital.

Productivity catch-up, however, cannot continue indefinitely; with luck and effective policies, economies catch up with the leaders. This happens more and more slowly as their levels converge. Moreover, investment cannot outpace the growth of the overall economy forever; capital spending eventually would absorb the entire national output. Japan is a case in point. According to a study by Harvard University's Dale Jorgenson and Masahiro Kuroda of Keio University, productivity growth in

Japanese industry in the 1960s was a phenomenal 4.1 percent per year; this pace slowed to only 0.16 percent in the 1970s. By the 1980s productivity levels barely improved at all.[19]

Related to the growth in productivity in the 1960s, investment in plant and equipment reached 21 percent of GNP in 1970 — meaning more than one out of every five yen of output flowed back into investment. By 1980 private nonresidential investment had fallen to 15.7 percent of GNP. It hovered around this level until the asset boom of the bubble economy in the late 1980s. Between 1988 and 1991 investment climbed once again to 20 percent of GNP.

This recent massive quantity of investment in plant, equipment, and research and development was qualitatively different from the earlier experience. For one thing, financial market liberalization meant that firms faced real interest rates; they now had to balance these financing costs against the returns from investing their funds. Studies by the Bank of Japan indicate that Japanese firms have become exquisitely sensitive to the returns on different types of assets. "Rates of return on financial assets have come to be a meaningful yardstick for opportunity cost of fixed investment. These changes in corporate finance, both in financing and in investment, have tended to widen the avenue through which interest rates influence business expenditure," according to a 1991 BOJ report.[20]

In the late 1980s, investment was stimulated by the run-up in asset prices and the consequent low cost of raising capital on financial markets. With the real cost of funds on the Tokyo Stock Exchange running close to zero or even negative, many investment and R&D projects looked like good bets since the public essentially was paying industry to take its money.[21] The returns on these investments consequently fell sharply as companies slid down their yield curves. Although the volume of Japanese investment in these years often has been cited as a replay of the Japanese economic miracle, the real contribution to future returns and productivity is likely to be meager. As the capital-output ratio has grown, larger and larger increments have been necessary to generate a unit of output.[22]

Japan is now among the technology leaders in the world. Its businesses no longer have the luxury of copying, licensing, observing, buying or borrowing from the leaders as they once did. They have to take their chances on the frontier, and there is no evidence that they make better bets than their foreign counterparts. The nation's capital-output ratio also is up among the world's leaders. Contributions from an increased flow of capital into production is yielding diminishing marginal returns. The period of productivity catch-up is over as Japan joins the ranks of the mature economies.

Implications: Pulling the Strands Together

Household savings influence two important activities: investment and trade balances. When Japan's domestic financial market was shut off from the rest of the world, investment depended on domestic savings; Japanese households were the principal source of net national savings.[23] Although deregulation and globalization of financial markets have weakened these ties substantially, domestic private investment still depends somewhat on domestic private savings.[24] To the extent that national boundaries matter in corporate access to investment funds, a declining share of domestic savings out of national income will constrain future Japanese investment.

A nation's net trade balance depends on the difference between aggregate income generated from production and expenditures. If a country spends more than it earns, that country will be a net importer and run a trade deficit, and vice versa. Some algebra applied to this relationship shows that a nation with positive net national savings (savings minus investment) will show a trade surplus. Trade balances, therefore, depend critically on the domestic savings-investment balance.[25] A fall in savings will drive real interest rates higher than they otherwise would be, with a downward effect on investment. Whether domestic investment falls even faster than household savings will depend as well on corporate and government savings and on other forces motivating investment.

When we consider the effects of the demographic changes, it does not require sophisticated economic analysis to suggest that a contracting labor force together with a growing economy implies higher real wages. Unless the productivity of labor can increase fast enough to neutralize the cost effects of higher wages, higher unit labor costs and a higher share of employee compensation in national income are likely results.

Productivity gains can come about from several sources: higher quality labor, more capital per labor hour, more productive capital or better ways of doing things (so-called disembodied technical change). Upgrading the labor force, mainly through improved educational levels, contributed about 1 percentage point of the gains in Japan's annual total factor productivity from 1960 to 1979, according to Harvard University's Mr. Jorgenson.[26] His calculations indicated that contributions from this source fell by more than half in the 1970s compared with the 1960-73 period. "Reduction in the rate of upgrading of the labor force was an important factor in the decline of economic growth," he noted.[27] There has been no indication of any dramatic improvements in labor force training and quality since then. In 1970 almost 79 percent of those completing lower secondary schools went on to upper secondary levels (see Table). This level had reached 93 percent by 1980 and inched up to 94 percent over the next decade. Those going on to higher education from the upper secondary schools reached a peak of 33 percent in the mid-1970s and then stabilized at the 30-percent level. These trends suggest a stabilization of the educational level of the Japanese labor force.

Percentage of Students by Level of School Who Advance to Schools of Higher Grade

Year	Lower Secondary	Upper Secondary	University
1960	54.9%	16.5%	3.6%
1965	67.4	24.5	4.9
1970	78.7	23.2	5.0
1975	90.0	33.1	4.9
1980	93.0	31.3	4.4
1985	93.1	30.1	5.9
1990	94.3	30.3	6.8

Source: Management and Coordination Agency, Statistics Bureau, *Japan Statistical Yearbook 1991.*

As noted above, the capital investment boom of the late 1980s drove down the rates of return of investments in plant and equipment and R&D; total factor productivity gains from providing more and more capital per worker were pushed close to zero. Therefore, investment is unlikely to come to the salvation of higher labor costs in the near future.

Productivity improvements can come from learning to do things in more efficient ways; for this to occur it is helpful to be a technological laggard. Mr. Jorgenson estimated that pure technical change contributed 2 percentage points annually to output growth in the 1960-79 period, but for the subperiod 1973 to 1979 the contribution from this source fell to 0.1 point.[28] Similarly, a study by Steve Dowrick and Duc-Tho Nguyen of the Australian National University concluded that Japan's gains from technological convergence came to an end in the 1970s.[29] Japan apparently has exhausted many of the sources of productivity change.

Returning to the point of higher labor costs, Japanese industry is unlikely to be helped much by improved labor quality, higher capital-labor ratios or rapid productivity advance. The likely outcome is that labor will take a larger share of corporate incomes. This has not happened yet, and the current economic slowdown will mask the underlying forces in the short run. However, a rapid run-up in wages can be expected in those sectors where market conditions are least cushioned by long-term contracts; first, small firms in the services sector and then small firms in manufacturing will be hit, followed by big companies. At the same time higher nominal wages may be avoided for a while by decreasing the number of work hours per year (without wage reductions) and extending more fringe benefits. Eventually, however, the employee share of national income will rise to levels observed in other industrial countries. Over the 1981-90 period the average Japanese ratio of employee compensation to national income was 68.2 percent, a full 6 percentage points below the comparable U.S. number.[30] When output and productivity were growing rapidly, it made good economic sense to workers to accept a smaller share of output today in exchange for a much higher level tomorrow. However, when growth slows and labor is in a sellers' market, the calculus changes to favor higher rewards today. A logical outcome would be a squeeze on the share of national income going to profits, retained earnings and corporate savings.

Corporate savings (depreciation plus earnings) equaled about 90 percent of real investment between 1981 and 1986 for all Japanese companies.[31] If, as suggested, a greater share of future corporate income goes to labor, companies will be forced to go to financial markets to raise funds for investment. Financial officers and corporate decisionmakers will confront the real cost of financial capital as never before and have to compare financial costs with expected project returns. As shown by the Bank of Japan, corporate managers already are responsive to differentials on the returns to financial assets; they now will have to apply earnings tests to equipment and R&D investments.[32]

If the rate of investment falls because of lower household and corporate savings and this decline is coupled with the end of productivity catch-up, Japan's total factor productivity growth will suffer on both accounts. Moreover, given four conditions — the size of the labor force falls, the number of hours worked drops, the rate of investment declines and productivity growth slows — output growth is bound to decline.

This projected decline in economic growth rates will occur as the economy becomes more open domestically and internationally because of the continuing process of deregulation and the removal of formal and informal barriers. Due to the greater efficiency brought about by competition in formerly regulated sectors, these moves should reduce costs to both producers and consumers. The shift in national income toward workers together with more competition and efficiency will tilt the Japanese economy toward the interests of the consumer — not because of any specific policy but through the evolution of powerful economic forces.

Whether these changes also imply the elimination of Japan's aggregate trade surplus is a more knotty question. The trade balance depends on the difference between two large quantities, both of which are projected to decline: national savings and investment. What happens to the trade balance will depend on the relative rates of change in these two quantities. Since households seem to be adjusting their savings behavior more slowly than the corporate sector, investment could fall more rapidly, thus leading to an enlarged trade surplus. As households save less, the difference between exports and imports should shift toward balance; however, the process could take years. In the period of high international capital mobility during the gold-standard era some countries — such as the United Kingdom — ran current account surpluses averaging 4.5 percent of GNP for as much as a 30-year period, while other countries ran deficits as large or larger.[33]

Countries today in search of capital — Russia, Eastern Europe, the developing world, the United States — are hoping for a continued net outflow of Japanese investment capital, which means an attendant trade surplus. Those countries anxious about trade competition — Western Europe as well as the United States — are aiming for a reduction in Japan's surplus.

The main results of the ongoing transformation of the Japanese economy are clear: a contracting labor force, declining household and corporate savings rates, falling rates of investment, ebbing productivity growth, slowing economic growth and a shift of national income to labor. Yet what effect all these developments will have on the Japanese economy still depends on sometimes unforeseen elements.

Conclusion: Cautions and Warnings

Since predictions are risky and may rest on either faulty logic, incorrect assumptions or a misunderstanding of the underlying forces, it is useful to consider alternative scenarios of the key variables that could disrupt the predictions. These indicators of predictive failure could alert analysts to other outcomes.

Household savings could continue higher than projected in response to the demand for funds elsewhere in the world; in other words, higher real interest rates outside Japan could stimulate more savings than called for by the other factors. As an example of this phenomenon, several analysts have calculated that U.S. fiscal policies in the first half of the 1980s, which resulted in the surge of the federal budget deficit, induced additional savings in Japan because of the increased global demand for capital; this induced change equaled an estimated 1.4 percent of Japanese GNP or about 2 percent of disposable income.[34]

Deregulation of inefficient sectors could release sufficient numbers of workers to counter the decline in the labor force. Certain sectors, such as agriculture as well as wholesale and retail trade, are less than half as efficient as their U.S. counterparts. Massive gains in productivity in shops, warehouses and the distribution system could provide the necessary quantity of workers to supply the rest of the economy; this one-time productivity gain, though, eventually would be overtaken by the downsizing of the labor pool.

Women are the great unused resource of Japan. Even though female labor force participation is high by the contemporary standards of advanced economies, employers in Japan make little use of women's capabilities there. In the conflict between economic and social forces this area is rife with potential for change and requires careful monitoring.

Foreigners, also, are little used by Japan's employment system. Although the number of legal and illegal foreign workers is growing rapidly, their absolute number still is only a tiny fraction of the labor force. However, economic pressures for relaxing the restrictions on immigrant labor are having a noticeable effect on law and policy. Foreign workers eventually could provide future relief to tight labor markets (see *JEI Report* No. 7A, February 21, 1992).

Finally, productivity advances could yield a gold mine. The intense competition in manufacturing in the postwar period motivated a search for production methods (and later for more effective product development procedures) that yielded the reknowned Japanese production system that now is changing the way the world makes things. This innovation, which in many ways was one of the most profound of the past 40 years, helped to transform Japanese industry. Under the pressures of the future, could there be other innovations with as startling and as profound effects?

The growth of the Japanese economy has brought it to a level today that ranks Japan among the largest and the most productive nations in the world. However, the next decade or so will be quite different from the past. Japan will not overtake the United States in terms of GNP by the turn of the century or even in 20 years as a few recent popular projections have contended. Even if the difference in the growth rates of the two economies were as great as the 1.6 percentage point differential of the 1980s, the size of Japanese output would not equal that of this country's for another 59 years.[35]

In terms of economic growth rates, investment, productivity and capital flows to the world, Japan is becoming a "regular" country. It is certainly a country of stature but not quite the economic or financial superpower proclaimed by those who were dazzled by the fireworks of the late 1980s.

Short-term events, such as recessions and bubbles, can blind one from closer attention to the fundamentals. Simple extrapolation of trends is an insufficient guide to the future. It is better to try to understand the underlying forces and how they are changing, while recognizing that the future, by its nature, is unpredictable.

For further information, contact **Arthur J. Alexander**.

NOTES

[1] Dale W. Jorgenson, "Productivity and Economic Growth in Japan and the United States," *American Economic Review*, May 1988, p. 217.

[2] Charles Yuji Horioka, "Why is Japan's Household Saving Rate So High? A Literature Survey," *Journal of the Japanese and International Economies*, IV, 1990, p. 51 (Table 1).

[3] *Ibid*. (Table 2).

[4] *Ibid*., p. 60.

[5] F. Modigliani and A. Sterling, "Determinants of Private Saving with Special Reference to the Role of Social Security — Cross-Country Tests" in F. Modigliani and R. Hemming (eds.), *The Determinants of National Saving and Wealth* (New York, New York: Macmillian, 1983).

[6] Bank of Japan, *Recent Changes in Japan's Labor Market and Their Impact*, No. 202, May 1991, p. 5 and Chart 8.

[7] Arthur J. Alexander and Kong Dan Oh, *The Development and Structure of Consumer Credit in Japan* (N-2902) (Santa Monica, California: The Rand Corporation, June 1989), p. 40.

[8] Each of these exemptions had limits of ¥3 million (about $22,200 at ¥135=$1.00), but families often had multiple accounts so that they seldom were affected by the limits.

[9] Horioka, *op. cit.*, p. 71.

[10] Organization for Economic Cooperation and Development, *OECD Economic Surveys: Japan 1989/1990* (Paris, France: 1990), p. 117 (Table A11).

[11] "Credit Card Users Facing An Unaccustomed Crunch," *The Asian Wall Street Journal Weekly*, September 16, 1991.

[12] *Ibid*.

[13] Management and Coordination Agency, Statistics Bureau, *Japan Statistical Yearbook 1991*, Table 2-2.

[14] Bank of Japan, *op. cit.*, p. 3 and Chart 3.

[15] Edward N. Wolff, "Capital Formation and Productivity Convergence Over the Long Term," *American Economic Review*, June 1991, p. 571 (Table 2).

[16] A detailed chronology of financial market deregulation is given in Organization for Economic Cooperation and Development, *OECD Economic Surveys: Japan 1990/1991* (Paris, France: 1991), pp. 137-148 Table A7).

[17] Kent Calder, *Crisis and Compensation* (Princeton, New Jersey: Princeton University Press, 1988), pp. 440-480.

[18] These figures measure "total factor productivity," which includes capital as well as labor inputs; they apply to economywide measures of gross domestic product. See Wolff, *op.cit.*, p. 568 (Table 1).

[19] Dale W. Jorgenson and Masahiro Kuroda, "Productivity and International Competitiveness in Japan and the United States" in C.R. Hulten (ed.), *Productivity in the U.S. and Japan: Studies in Income and Wealth* (Chicago, Illinois: University of Chicago Press, 1990). See also *JEI Report* No. 4A, January 31, 1992 for the comparative results of other studies.

[20] Bank of Japan, *Corporate Financing and Business Investment under Financial Deregulation,* Special Paper No. 195, February 1991, p. 7.

[21] At the peak of the Tokyo stock market in late 1989 the price-earnings ratio was 65 — implying a 1.5 percent cost to raise financial capital through issuing stock. Wholesale prices of manufactured goods were rising 1.5 to 2 percent in the 1988-90 period. The real cost of capital raised on the stock market therefore, was -0.5 percent to zero. For price-earnings ratios for companies listed on the first section of the Tokyo Stock Exchange, see *Ibid.*, p. 28.

[22] *JEI Report* No. 4A, January 31, 1991, p. 9.

[23] Corporations historically have been net borrowers from the rest of the economy, although since the 1980s their dependence on the household sector has fallen markedly. The savings of government at all levels have fluctuated over the years, running small surpluses (on a national accounts basis) in the 1960s, accruing large deficits in the late 1970s and gradually moving into surplus in 1987.

[24] Cross-section statistical analysis of 10 industrialized nations shows a declining relationship over time between private savings and private fixed investment, with Japan possessing the highest values of both variables over the 1966-85 period. Time-series analyses of individual countries, however, show no simple correlation between the variables. See Tamim Bayoumi, "Saving-Investment Correlations: Immobile Capital, Government Policy, or Endogenous Behavior," *IMF Staff Papers*, June 1990, pp. 376-379.

[25] According to the way that national income accounts are calculated, savings minus investment always equals exports minus imports. In the very short run economic forces tend to move from the trade side of the equation to the domestic side; for example, if petroleum prices were to fall, Japanese imports would decline, the trade surplus would increase and domestic consumption would decline (savings would increase) as producers and consumers spent less for oil. Over the longer run as measured in years, however, the influence tends to move from net savings at home to an impact on the international trade sector. For example, the increase in the corporate savings rate that occurred in the 1970s translated into trade surpluses.

[26] Jorgenson, *op. cit.*, p. 218.

[27] Jorgenson, *op. cit.*, p. 219.

[28] Jorgenson, *op. cit.*, p. 218

[29] Steve Dowrick and Duc-Tho Nguyen, "OECD Comparative Economic Growth 1950-85: Catch-up and Convergence," *American Economic Review*, December 1989.

[30] The Japanese figures are from Management and Coordination Agency, Statistics Bureau, *Japan Statistical Yearbook 1991*, p. 562. The U.S. figures are from Department of Commerce, Bureau of the Census, *Statistical Abstract of the United States 1991*, p. 435.

[31] Bank of Japan, *Corporate Management Under Continued Economic Expansion*, Special Paper No. 199, March 1991, p. 18 and pp. 53-54 (Table 15).

[32] *Ibid.*, p. 7.

[33] Bayoumi, *op. cit.*, p. 375.

[34] Jeffrey D. Sachs, "Global Adjustments to a Shrinking U.S. Trade Deficit," *Brookings Papers on Economic Activity*, No. 2, 1988, p. 642 (Table 2).

[35] The period of convergence depends on the current ratio of the two countries' GNPs and the difference in their ratio of growth. In 1990 America's GNP was 1.73 times larger than Japan's at an exchange rate of ¥135=$1.00; however, using the more realistic purchasing power parity conversion of ¥200=$1.00, the ratio was 2.56. For those who may want to insert other assumptions into the calculation, the convergence period n is: $n = (\ln U/J)/(j-u)$, where U is American GNP in the base year, J is Japanese GNP, j and u are the Japanese and American growth rates (1.5 percentage point differential is 0.015) and ln is the natural logarithm.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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JEI

REPORT

A Two-Part Report: A and B

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March 20, 1992

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Bears, Scandals And Reforms Pummel Japanese Financial Markets

With all the melodrama of a soap opera, Japanese financial markets continue to grapple with a string of mostly domestic cataclysmic events. Punished by stock-loss compensation scandals last year, Japan's securities houses now face a growing number of potentially expensive lawsuits by clients angry over a stock trading practice somewhat akin to check kiting. Also, sweeping changes in the finance sector could result from a Ministry of Finance package of legislative proposals approved by Prime Minister Kiichi Miyazawa's cabinet March 13. And further destabilizing the scene, the Tokyo Stock Exchange's Nikkei average dropped March 16 to below the 20,000 mark, raising the specter of panic selling by large investors.

Revelations that Japanese brokerages compensated favored clients for stock trading losses over several years to the tune of nearly ¥172 billion ($1.3 billion at ¥135=$1.00) have wrought more than MOF punishments (see *JEI Report* No. 40B, October 25, 1991). Court and arbitration cases now coming to light have revealed another questionable trading practice involving similarly large sums. When equity prices on Japan's stock markets were skyrocketing in the late 1980s, Japanese brokers dreamed up a scheme called *tobashi* or "flying," which allowed clients to realize capital gains while the securities dealers earned commissions at the same time. *Tobashi* takes advantage of the fact that companies "close" or tally their investment portfolios at different times.

divided over various aspects. Indeed, the government also is split over some questions. The Ministry of International Trade and Industry, for example, wants to retain control of nonbank financial institutions, while MOF is lobbying for a common set of regulations for all financial firms. If the Diet can shift its attention from the various influence-peddling scandals now occupying much of its time, major reforms are likely to be enacted; their exact form and content still remain to be worked out.

Jon Choy

Surveys Point To Reduced Japanese Plant And Equipment Spending

Car owners know that when their car engine begins acting up, they should seek a good mechanic. Similarly, plant and equipment spending, often described since late 1986 as the engine of Japan's economic expansion, is offering clues that suggest that the economy itself is under strain and in need of countermeasures. Since plant and equipment spending in the last few years has accounted for more than 20 percent of gross national product in Japan, significant overall growth is unlikely if investment spending declines.

In early March several government organizations and businesses released surveys of firms' plans for plant and equipment spending in the fiscal year that begins April 1. On balance, the reports suggest that the engine of growth is likely to sputter in the coming 12 months. Investment by manufacturers in new plant and equipment will fall substantially, while nonmanufacturing investment will be relatively flat, according to the surveys. That points to a modest drop overall in business investment in FY 1992 (see Table). Moreover, for the first time in five years the Bank of Japan's February quarterly short-term survey of business enterprises (*tankan*) indicated a decreased level of capital spending for the coming fiscal year. BOJ's survey of large firms showed that they expect to reduce investment spending 3.2 percent in FY 1992. This finding contrasts sharply with that for FY 1991, which, when it comes to an end March 31, is expected to show an 8 percent rise in capital spending from FY 1990's level.

Plant and Equipment Surveys for FY 1992

(percent change from year earlier)

	Number of Firms Surveyed	Projected Change in Capital Spending		
		Total	Manufacturing	Nonmanufacturing
Industrial Bank of Japan, Ltd.	3,327	-4.0%	-10.7%	-0.9%
Nihon Keizai Shimbun	1,564	-4.9	-11.8	1.3
Japan Development Bank	2,145	-0.8	-6.4	3.2
Bank of Japan (*tankan*)*	689	-3.2	-8.2	0.2

*Large firms only.

The new *tankan* also reported the latest business conditions diffusion index for large manufacturing firms, a widely cited indicator of corporate sentiment. For the first time since 1987 the index — calculated as the excess of positive over negative responses — moved into negative territory, measuring a minus 12 percent versus a positive 13 percent three months earlier (see *JEI Report* No. 47B, December 20, 1991). Inasmuch as previous drops below zero have occurred during what passes for recessions in Japan, the latest reading provides additional evidence that Japan is in the midst of an economic downturn, even if official acknowledgement has not yet been forthcoming.

Some evidence suggests that plant and equipment spending in the coming fiscal year could be worse than the reports portend. Most surveys concentrate on large firms, yet investment by small companies is significant in the aggregate. BOJ's *tankan* survey of small firms showed that they plan to cut capital spending by an extraordinary 23.5 percent in FY 1992. The finding hints that the lower interest rates of recent months have not been sufficient to overcome pessimistic sentiment among small companies, which rely heavily on credit markets to finance fixed investment.

An Economic Planning Agency report issued in early March provides supporting, albeit somewhat different, evidence concerning the slowdown in plant and equipment outlays. Based on equipment orders already placed and taking into account the six- to nine-month lead time between when orders are placed and machinery is delivered, EPA estimates that capital spending will be 2.7 percent lower in the first six months of FY 1992 than a year earlier. Although the estimates by EPA and others are based on investment plans without any adjustment for price increases, capital goods inflation in recent years has been negligible in Japan, suggesting that real capital spending will be approximately the same as the nominal figure.

The forecasts of reduced overall business investment in the upcoming fiscal year imply a still high level of Japanese plant and equipment spending since increases in annual outlays have run in the double digits in recent years. However, the economy will not get a short-term boost from capital investment unless spending increases from the current lofty levels. Events that have occurred since the surveys were taken in late February and early March suggest that the small decreases in investment spending now anticipated could become much sharper as the year progresses. The *tankan* result concerning business sentiment, which was worse than expected, plus the fall of the Nikkei average to a five-year low March 16 (see preceding article) indicate that both the demand and the supply of funds in capital markets will be restricted in coming months.

Not surprisingly, business and political leaders in Japan have called for countermeasures in the form of lower interest rates. The Ministry of Finance was successful in indirectly talking long-term credit banks out of raising the long-term prime rate for March. In addition, the call to the master mechanic — Yasushi Mieno, governor of the Bank of Japan — has gone out in the form of a plea to lower the central bank's discount rate by as much as a full percentage point. Mr. Mieno, accused by some analysts of having thrown a monkey wrench into Japan's economic expansion in the form of continued high interest rates, so far has shown no sign he will drop the rate below its current level of 4.5 percent. That rate, set December 30, is half a percentage point lower than the one that had been in effect since November 14 (see *JEI Report* No. 1B, January 10, 1992). As noted above, small firms, which are most dependent on capital markets, have not responded positively to the 4.5 percent key rate. To ensure peak performance of the Japanese economy, a major tune-up may be in order in the form of a package of more extensive monetary actions as well as fiscal measures.

Douglas Ostrom

Pentagon Report Emphasizes Sound Alliances

The U.S.-Japan Mutual Security Treaty will continue to be an important element in Washington's post-Cold War defense strategy, according to the Department of Defense's 1992 report to the president and Congress. While acknowledging that the threat to global peace caused by the "expansionist ambitions of the Soviet Union" has disappeared with the demise of the former communist power, the 154-page defense document emphasized that, as demonstrated by the Persian Gulf War, potential regional conflicts will challenge America's national security interests. Moreover, the proliferation of weapons of mass destruction as well as the global diffusion of military and dual-use technologies will enable regional adversaries to acquire weapons capabilities that in the past were limited to the superpowers, the Pentagon maintained in the report released in late February. For

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REPORT

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JAPAN AND ASEAN: ASPECTS OF A NEW INTERDEPENDENCE

SUMMARY

The remarkable economic growth of the six members of the Association of Southeast Asian Nations in recent years has definite links to developments in their economic relations with Japan. The surge of Japanese investment in Southeast Asia following the appreciation of the yen in the second half of the 1980s was a major force in the region's economic expansion. Japan's growing manufacturing presence during this period helped build up the industrial base of many Asean nations, contributed significantly to the escalation of Asean exports and imports, and changed the composition of the region's trade flows. Yet even as recent Japanese investment in the region has tightened the ties between Japan and Asean, some have questioned the impact of this presence both on Asean countries and on the region's trade partners.

Southeast Asian nations no doubt will continue to vie among themselves and with other regions for Japanese investment. Yet Asean members are likely to have higher expectations for future investment as their plans for economic growth enter a more advanced stage. Moreover, as regional trade linkages increase in other parts of the world, Asean nations may try to help guide Japan's role as an economic leader in Asia.

Overview

Intensified trade tension between the United States and Japan has generated attention at times on Japan's expanding economic presence in Asia and particularly on the role Japan has played in the export-led growth of the countries that comprise the Association of Southeast Asian Nations — Thailand, Singapore, Malaysia, the Philippines, Indonesia and Brunei. Playing into concerns about Japan's increasingly dominant economic role is a sense in some corners that the United States is losing out on opportunities in Southeast Asia. Direct investment data are difficult to compare, and some analysts believe that the United States still has the largest direct investment position in some Asean nations. Yet the pace of U.S. investment in the region clearly is lagging

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behind Japan's. In 1990 new Japanese direct investment proposals and approvals in Asean exceeded those of U.S. companies by more than four times.

Moreover, Japanese investment in Asean has boosted its trade with the region. In 1990 Japan exported almost $33 billion in goods to Asean, compared to nearly $19 billion in U.S. exports to the region. Analysts warn that the United States cannot afford to ignore the export opportunities the Asian market offers; Asean nations alone are home to 320 million people.

A related fear is that tighter Japanese trade and investment links with the region will lead to an Asian trade bloc that excludes the United States. Although some economists discount this possibility, their explanations may not be reassuring to American or Asean business and political leaders. Peter Petri of Brandeis University, for example, has attributed much of Japan's expanding trade with Asia to "triangular trade." This country's trade ties to Asia are unlikely to be severed because of the importance of trade flows in which "components and equipment are exported to Asian nations by Japan, and final products go from the Asian countries to the European and U.S. markets," Mr. Petri has said.[1]

Many in the United States and in Asean see problems in this type of trade pattern. Some analysts, for example, attribute the 1987-90 reduction in the U.S. trade deficit with Japan in part to Japan's expanded manufacturing presence in Asia. By moving assembly operations to third countries, they assert, Japanese industry has had a hand in "transferring export statistics from Japanese to other countries' trade figures and reducing the deficit attributable to Japan."[2] In addition to clouding the question of the U.S.-Japan trade imbalance, critics contend, this causes problems for Asean nations trying to keep trade surpluses in line or facing U.S. import quotas on certain products.

Distinct economic pressures contributed to the near doubling of Japan's foreign direct investment position in Asean between FY 1986 and FY 1990. The appreciation of the yen against the dollar after 1985 forced Japanese firms to find ways to remain competitive. Many moved their manufacturing operations to neighboring Asian countries in search of lower production costs as well as to increase their market share in host nations and in third countries. While recognizing the boon the Japanese presence has represented for Asean economies, some observers argue that Japanese government and business leaders should do more to ensure that such investment will result in long-term benefits for the region.

Developing Japan-Asean Economic Relations

While geographical, historical and cultural ties provide a strong foundation for Japan-Asean relations, the region's resources, markets and economic opportunities are key factors in a growing interdependence. In the 1960s and 1970s the economic relationship was rather imbalanced, with Japan relying on various Asean members for raw materials, as markets for growing Japanese exports of manufactured goods and as sites for new investment. By the late 1970s Asean discontent with what was perceived as Japan's increasing economic domination over the region led Tokyo to develop a new approach in which the emphasis was one of greater partnership with the six nations, accompanied by pledges of expanded economic assistance and increased imports from the region (see *JEI Report* No. 14A, April 10, 1987).

Since announcing its new policy toward Asean in 1977 Japan has been the region's largest provider of economic assistance. The importance of the region's economic stability to Tokyo is reflected in the consistently large share of Japan's official development assistance that Asean nations receive. In 1990 foreign aid amounting to $2.3 billion was directed to Asean, a sum that represented

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more than 33 percent of Japan's total ODA that year. Additionally, the Philippines, Thailand and Indonesia have been among the top 10 recipients of Japan's economic assistance for the last several years, and Malaysia frequently has been among the major recipients (see *JEI Report* No. 45A, December 6, 1991).

In recent years a significant share of Japan's foreign aid to Asean members has consisted of loans, a form of economic assistance that Tokyo sees as encouraging economic discipline among recipients and as being more appropriate to the region's development needs. The Ministry of Foreign Affairs' 1990 ODA report noted that "the development of the Asean economies will be accompanied by a shift in the content of ODA toward a primary emphasis on loans and technical cooperation. ... In the long-term future, they [the Asean economies] are also expected to advance beyond the need for ODA loans."

Recent Initiatives for Regional Development

Tokyo's aid approach for Southeast Asia provides a particularly clear example of the close relationship between the Japanese government and the private sector. The comprehensive nature of Japan's economic assistance to the region was emphasized by then Prime Minister Toshiki Kaifu during his 1991 trip to the region. Through its official development assistance to Asean, Mr. Kaifu noted, Japan was attempting to respond to the "diverse development needs of the recipient countries, fully mindful of the role played by trade, investment, and technology transfer. ..."[3] Underscoring the importance of foreign investment to Asean's economic growth, the government earmarked most official loans to the region for improvements in the economic infrastructure. In addition to improving the investment climate by developing the power, transportation and telecommunications systems of the recipient nation, such loans can open business opportunities for Japanese firms as well as assure investors that Tokyo sees the recipient as a safe bet.

Efforts by the Ministry of Foreign Affairs to develop the industrial bases of Asean members include the $2 billion Asean-Japan Development Fund, established in 1987 in part to provide low-interest loans for joint ventures in the region (see *JEI Report* No. 1A, January 6, 1989). AJDF also facilitates coordination between private Japanese capital and the government-backed Japan-Asean Investment Corp., established in 1981 to help boost Asean economic development.

Also in 1987 the Ministry of International Trade and Industry formally announced the New Asian Industries Development Plan, aimed in part at helping to develop the region's export industries (see *JEI Report* No. 14A, April 10, 1987). The plan attempted to address Asean concerns about the nature of Japanese investment in the region, which at the time was involved largely in natural resource development and a number of offshore assembly plants.

The New AID Plan's objective of boosting the region's production of manufactured goods met with some wariness both within Asean and in the United States. Fears that Japan would not increase its imports of Asean-produced goods led to questions about where the expanded volume of exports would be directed. The New AID Plan also has been a magnet for criticism that Tokyo has initiated a strategy to coordinate the development of Southeast Asia in line with Japan's economic objectives. Some critics contend, for example, that Japanese government officials have steered Asean industrial planners toward products that best fit Tokyo's plan for the region. David Arase of Pomona College presents a policy with more monetary overtones: "In essence, the policy objective is to mate Japan's capital surplus with that country's strength as an exporter of whole plants and capital goods to transplant into Asean those Japanese manufacturers threatened by the yen's appreciation."[4]

Japanese government officials indicate that MITI's plans for coordinated economic development are not official government policy. Some observers point out that many of the projects outlined by the New AID Plan were never actually funded. Moreover, analysts disagree on the extent to which the government has motivated recent Japanese investment in Southeast Asia. Richard Cronin of the Congressional Research Service noted, "Whether this picture of a strategic plan for integrating Southeast Asia into the Japanese economy is alarmist or realistic is difficult to answer with any certainty." He further pointed out, "Japanese multinationals and their bureaucratic allies are primarily interested in expanding or maintaining their worldwide market shares, not the creation of a new 'co-prosperity sphere.'"[5]

Japanese Investment in Asean

As of the end of FY 1990 Japan's cumulative investment in Asia represented slightly more than 15 percent of its worldwide foreign direct investment versus about 43 percent in North America and just over 19 percent in Europe. Investment in Asean nations — 8.8 percent of the Japanese total — constituted more than half of Japan's investment in Asia (see Table 1). In 1990 Japan was either the largest or the second-largest winner of new foreign investment approvals for the five biggest Asean nations, according to the U.S.-Asean Council. (Comparable investment data were not available for Brunei.) While two decades ago American investment predominated in Southeast Asia, by 1990 Japan's investment position was roughly twice that of the United States, the U.S.-Asean Council reported.

Table 1: **Japan's Foreign Direct Investment in Asean, FY 1986-FY 1991 First Half**

(in millions of dollars)

	FY 1986	FY 1987	FY 1988	FY 1989	FY 1990	First Half FY 1991	Total September 30, 1991
Brunei	$1	$0	$0	$0	$0	$0	$109
Indonesia	250	545	586	631	1,105	412	11,952
Malaysia	158	163	387	673	725	462	3,694
Philippines	21	72	134	202	258	82	1,662
Singapore	302	494	747	1,902	840	286	6,840
Thailand	124	250	859	1,276	1,154	487	4,910
Total Asean	856	1,524	2,713	4,684	4,082	1,729	29,167

Source: Ministry of Finance

In contrast to Japanese investment in Asean in the 1970s, which was concentrated in natural resource development and labor-intensive manufacturing like textiles, the post-1985 period saw Japanese makers of consumer and other electronics products as well as producers of automotive parts shift assembly of more low-end products to the region. The web of recent investment by Japanese multinationals in Southeast Asia has resulted in what CRS's Mr. Cronin has described as a "regional production base ... involving the manufacture of various components, final assembly and even product design and development across national boundaries in accordance with each country's particular resource endowments, economic infrastructure or labor markets." Mr. Cronin noted that over the long term Japanese economic managers in Asia, "[A]ppear to seek an optimum 'division of labor' that maximizes each country's comparative advantage, thus fostering complementary rather than competitive patterns of industrialization."[6]

Impact of Japanese Investment on Asean Nations

The pattern of economic development in Asia frequently is described as that of "flying geese," where Japan leads a formation of Asian economies in which each gains from the economic and technological experience of members of the group whose development precedes its own. Some Asean members have made a concerted effort to follow the Japanese model of industrialization. In 1978 Singapore launched an official "Learn from Japan" campaign. In 1982 Malaysia's Prime Minister Mahathir Mohamad announced a "Look East" policy that he described recently as implying "[L]earning the work ethics, management styles and organizations of those countries in the East which were achieving dynamic growth."[7] The Japanese government's policy of cooperating with and encouraging business was a key feature both countries sought to imitate.

While "Look East" still is considered an important Malaysian policy, some analysts have noted that Southeast Asia's embrace of the Japanese model has loosened as nations in the region have realized the differences that separate their societies from Japan's and have reevaluated their image of the Japanese private sector. Moreover, trading partners' accusations that they have adopted Japan's alleged "mercantilist" trade practices also pose a risk for Asean nations. Companies in both the United States and the European Community, for example, have filed dumping and subsidization complaints against items processed in Thailand by Japanese companies or using Japanese components.

Beyond these considerations are certain spin-offs of the Japanese business approach for Asean nations. In theory, for example, the Japanese preference for joint ventures over wholly owned subsidiaries (which U.S. investors tend to favor) allows both parties to an agreement more flexibility and offers greater opportunities for technology transfers. Compared to other foreign investors Japanese businesses are seen as less likely to be frightened off by potential political instability in a host country. Japan's investment insurance coverage has given some Japanese firms the confidence to start operations, since the program takes into account a country's political situation.

Yet some aspects of corporate Japan's management style can be sources of tension for the host nation. Frequently cited examples are the tendency of Japanese companies to keep top management posts in Japanese hands and to transfer technology cautiously, even in joint ventures. Japanese business representatives reportedly counter these complaints by stressing that it takes time for local employees to learn the technology and how a particular company operates. Some also point to the competitive risks inherent in technology transfers. Yet Asean observers say that American and other foreign investors have a better record of training Asean nationals and placing them in management positions.

Japanese firms also have been accused of constricting their affiliates' activities by providing inadequate training and by placing restrictions on exports. In addition, critics have targeted some Japanese manufacturing operations in Asean for substandard working conditions and drastic layoffs. In Malaysia, for example, the grievances of workers in Japanese factories have included poor ventilation, extreme temperatures and exposure to dangerous chemicals. In some Asean nations local retailers and producers complain about being squeezed out of the domestic market by goods produced by Japanese affiliates.

A lack of cultural integration also is a concern among Asean countries where Japanese businesses invest but then appear to remain isolated from the community. A 1991 report of a survey conducted by Keizai Doyukai (Japan Association of Corporate Executives) indicated that, although most Japanese investors recognize this as a problem, they may be slow to address it. The survey of Japanese business representatives in Southeast Asia found that more than 80 percent said they felt they should increase their respect for local culture and customs, yet only 27 percent of those polled said they should contribute more to the local community and only 18 percent said they should promote personal exchanges with nationals.

Further issues that pit the value of investment against societal concerns include worries that Japanese investment will encourage a widening gap between rich and poor. Some Asean political leaders also question the environmental harm to the region from Japanese firms that do not exercise the same safeguards they would at home. Certain Japanese firms, for example, allegedly shifted processing facilities to Southeast Asia to avoid antipollution pressures in Japan. Malaysia, for one, has indicated that pollution control is a priority and that it will not welcome pollution-causing foreign investment. Moreover, a number of analysts predict that unless the pace of Japanese investment slows, some Asean nations will face serious shortages of skilled labor as well as inflated wages and land prices.

These and other concerns have led Asean countries, as their economies advance, increasingly to press for investment that utilizes and contributes to a skilled labor force as well as expands technological capabilities. Political and business leaders in the region also want investors to improve the infrastructure and to increase access to low-cost financing. These objectives do not always coincide neatly with those of foreign investors. Mr. Cronin of CRS concluded that one source of friction facing Japanese investors and Asian host countries is "the conflict between the drive of Japanese companies to integrate their offshore manufacturing operations on a regional basis, versus the aspirations of many developing countries to maximize their domestic industrial self-sufficiency."[8] Reconciliation of these objectives is hampered, he noted, because Japanese firms probably would not move production overseas if the solution to remaining profitable had been simply to increase investment at home or to develop new products. Moreover, he added, not only do Japanese manufacturers prefer to maintain tight control over their technology, they also tend to continue at their overseas plants their existing relationships with subcontractors and suppliers. In 1988 almost 40 percent of the inputs used by Japanese affiliates producing manufactured goods in Asean nations was sourced from Japan (see Table 2).

Table 2: **Procurement by Asean Affiliates of Japanese Firms, 1988**

	Share of Sourcing From			
	Local	Japan	Asia	Other
Total Industry	43.6%	39.0%	9.3%	8.1%
Manufactured Goods	41.9	39.2	14.8	4.1
Food	98.8	0.8	0.4	0.0
Textiles	39.6	34.3	15.7	10.4
Wood and Pulp	95.8	2.8	0.0	1.4
Chemicals	43.6	23.3	4.4	28.7
Steel	29.4	45.1	17.8	7.7
Nonferrous Metals	54.2	33.3	0.6	11.9
Nonelectric Machinery	49.2	45.6	5.1	0.1
Electric Machinery	32.5	40.3	24.6	2.6
Transport Equipment	39.0	47.3	13.5	0.2
Precision Equipment	7.9	85.0	2.8	4.3
Petroleum and Coal Products	64.4	35.6	0.0	0.0
Others	61.4	23.6	9.3	5.7

Source: Ministry of International Trade and Industry

On a larger scale Asean members have questioned whether their economies will become overly dependent on Japan. Beyond their dissatisfaction with specific Japanese business practices, many Southeast Asian government officials are wary of potential Japanese economic domination in the region. Some stress the need to attract American and European investment to maintain a foreign investment balance. During President Bush's January trip to the region news reports quoted Singapore's Prime Minister Goh Chok Tong as calling for the United States to be a "partner in our economies to help balance the growing presence of Japan."

Other Investment in Asean

Although new Japanese investments have overtaken new American commitments in Asean, the United States still maintains a healthy investment position in the region. American investment there totaled $12.3 billion at yearend 1990, up from $10.2 billion a year earlier. More than half of that money was invested in Singapore and Indonesia. This country traditionally has concentrated much of its Asean investment on the petroleum industry. Between 1985 and 1990, however, U.S. manufacturing investment in Southeast Asia rose 113 percent, while U.S. petroleum investment dropped in most Asean countries. At yearend 1990 the American direct investment position in Asean's manufacturing sector was valued at $4.6 billion, 37 percent of total U.S. investment there.

American businesses, like their Japanese counterparts, have used Asia and the Asean nations, in particular, as production bases. In 1988 about 21 percent of American firms' production took place outside the United States (not specifically in Asia), compared to the roughly 5 percent share of Japanese manufacturers' output that was produced offshore. Also like their Japanese counterparts, American affiliates in many manufacturing industries sell a significant share of their output in local markets. (For a discussion of the export patterns of American and Japanese affiliates in Asia and in general, see *JEI Report* No. 9A, March 6, 1992.) In high technology industries, however, U.S. companies involved in Asia as a whole ship most of their products back to the parent company. This is in contrast to Japanese firms in Asean, which direct most high technology manufactures to other Asian countries or to markets outside the region (see Table 3). For some Asean countries products made by U.S. affiliates represent a significant share of exports to the United States. One economist has estimated, for example, that more than half of Singapore's exports to this country are produced by American subsidiaries there.[9]

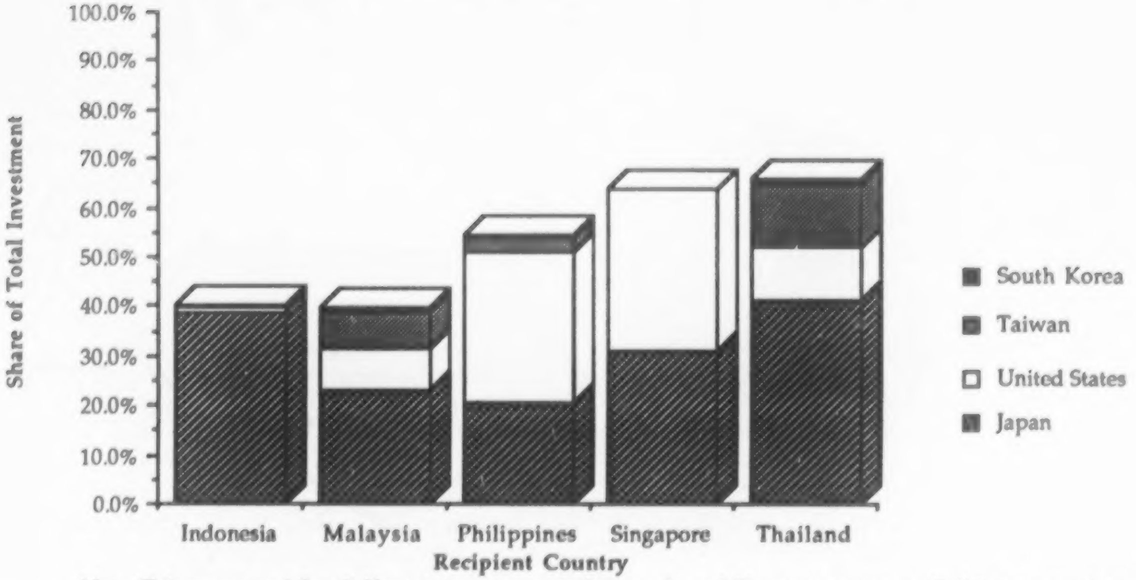
Table 3: **Sales by Asean Affiliates of Japanese Firms, 1988**

	Share of Sales To			
	Local	Japan	Asia	Other
Total Industry	66.9%	10.5%	8.7%	13.9%
Manufactured Goods	61.1	12.5	12.5	13.9
Food	14.4	34.7	27.2	23.7
Textiles	59.3	9.3	11.5	19.9
Wood and Pulp	18.7	46.0	23.8	11.5
Chemicals	91.1	4.4	3.6	0.9
Steel	91.1	5.9	1.4	1.6
Nonferrous Metals	41.3	42.4	8.6	7.7
Nonelectric Machinery	96.8	2.6	0.5	0.1
Electric Machinery	31.6	13.3	26.2	28.9
Transport Equipment	96.8	1.2	1.2	0.8
Precision Instruments	3.3	15.4	41.8	39.5
Petroleum and Coal Products	98.7	0.8	0.2	0.3
Others	81.5	10.2	4.8	3.5

Source: Ministry of International Trade and Industry, 1990

Such intrafirm types of trade flows are expected to shield Singapore from any move toward protectionist policies in this country. Yet Asean as a whole relies heavily on the United States to absorb its exports. These goods are being manufactured not only by American- and Japanese-affiliated firms but increasingly by production facilities owned by other Asian nations. The acceleration of investment from Asia's newly industrialized economies — South Korea, Hong Kong, Taiwan and Singapore — has been one of the most striking investment trends in Asean (see Figures 1 and 2).

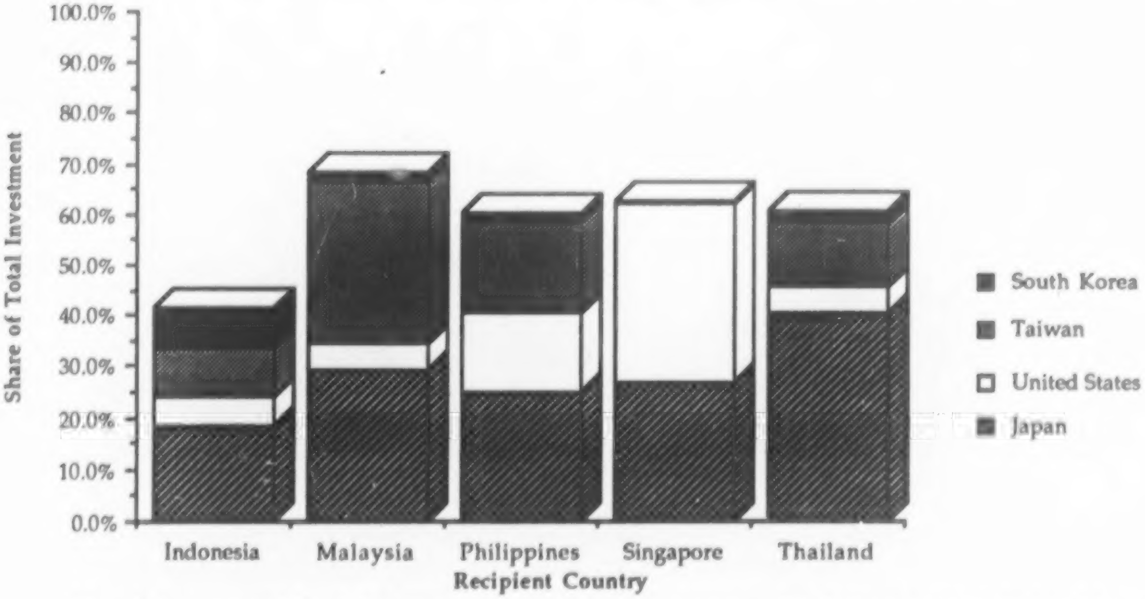
Figure 1: **Foreign Direct Investment in Asean Countries, 1985-87**



Note: Taiwanese and South Korean investment in Indonesia and Singapore were negligible or nonexistent during this period.

Source: Ministry of Finance

Figure 2: **Foreign Direct Investment in Asean Countries, 1988-90**



Note: Taiwanese and South Korean investment in Singapore were negligible or nonexistent during this period.

Source: Ministry of Finance

Ironically, while competition with the NIEs was one factor motivating Japanese firms to move production in the mid-1980s to Southeast Asia for lower-cost labor, among other reasons, the need to remain similarly competitive has compelled Asia's "four tigers" to follow Japan to Asean. Strengthened currencies and trade deficits with the United States have motivated Taiwan and South Korea, in particular, to move production offshore.

Japan's Trade with Asean

In 1991 Japan imported $31.8 billion from Asean compared to the $20.8 billion the United States imported from the region (see Table 4). Yet while manufactured goods represented 68 percent of this country's imports from Asean in 1989 (the latest year for which comparative data are available), only 18 percent of Japan's imports from the region consisted of manufactures (see Figures 3 and 4).

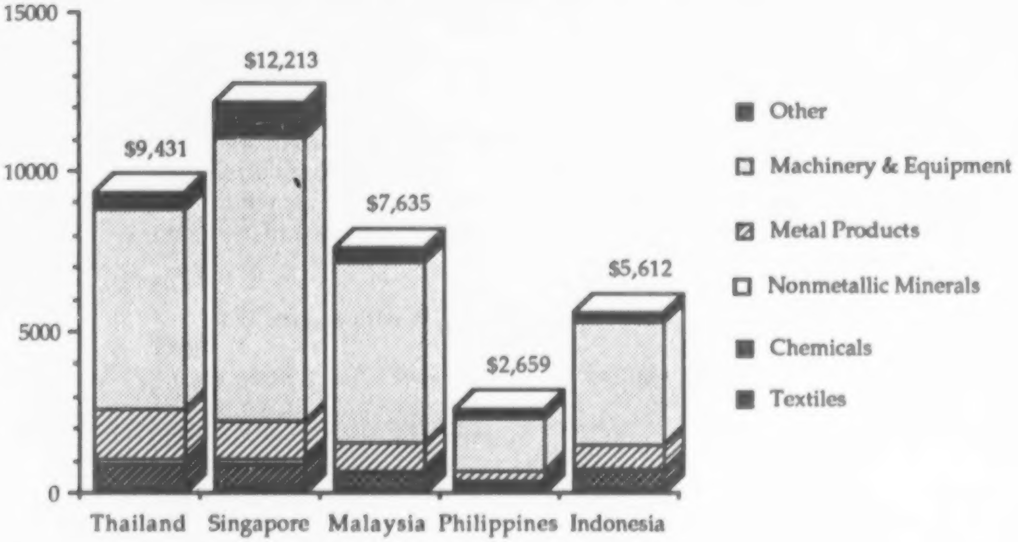
Table 4: **Japan's Trade with Asean, 1987-91**

(in millions of dollars; exports f.o.b., imports c.i.f.)

	1987	1988	1989	1990	1991
Brunei					
Exports	$40	$67	$83	$86	$129
Imports	1,184	1,117	1,086	1,262	1,500
Trade Balance	-1,144	-1,050	-1,003	-1,176	-1,372
Indonesia					
Exports	2,990	3,054	3,301	5,040	5,613
Imports	8,427	9,497	11,021	12,721	12,770
Trade Balance	-5,437	-6,443	-7,720	-7,682	-7,157
Malaysia					
Exports	2,168	3,060	4,124	5,511	7,635
Imports	4,772	4,710	5,107	5,402	6,471
Trade Balance	-2,604	-1,650	-983	110	1,163
Philippines					
Exports	1,415	1,740	2,381	2,504	2,659
Imports	1,353	2,044	2,060	2,157	2,352
Trade Balance	62	-304	321	347	308
Singapore					
Exports	6,008	8,311	9,239	10,708	12,213
Imports	2,048	2,339	2,952	3,571	3,415
Trade Balance	3,961	5,972	6,287	7,137	8,799
Thailand					
Exports	2,953	5,162	6,838	9,126	9,431
Imports	1,796	2,751	3,583	4,147	5,252
Trade Balance	1,157	2,410	3,256	4,979	4,179
Total Asean					
Exports	15,574	21,394	25,966	32,975	37,679
Imports	19,580	22,458	25,809	29,260	31,759
Trade Balance	-4,006	-1,064	157	3,715	5,920

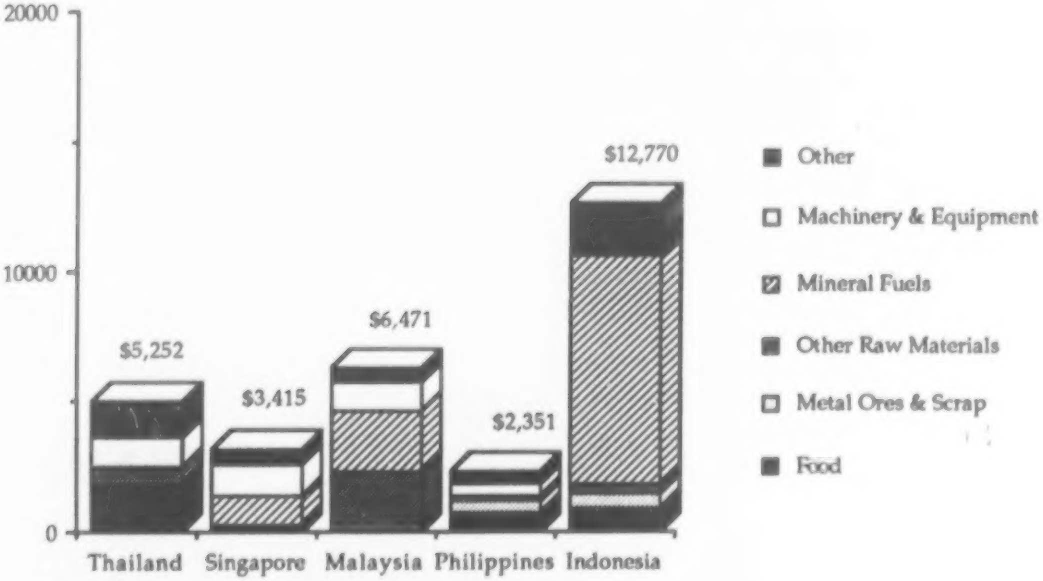
Source: Ministry of Finance

Figure 3: **Japan's Exports to Asean Countries, 1991**
(in millions of dollars)



Note: Figures less than $200 million are not reflected in this graph.
Source: Japan Tariff Association

Figure 4: **Japan's Imports from Asean Countries, 1991**
(in millions of dollars)



Note: Figures less than $200 million are not reflected in this graph.
Source: Japan Tariff Association

Although the share of manufactured products in Japan's imports is approximately double that of 1985, it has not kept up with the dramatic rise in the proportion of Asean exports represented by manufactured goods. Moreover, some analysts have suggested that the cause of the recent decrease in Japan's share of total Asean exports is that country's reluctance to open its market fully to Asean-made manufactured products (see Table 5).

Table 5: **Destination of Asean Exports, 1984 and 1990**

(in millions of dollars)

	1984		1990	
Destination	Amount	Share	Amount	Share
United States	$15,040	19.2%	$27,936	19.8%
Japan	20,556	26.2	26,798	19.0
Other Asean*	16,326	20.8	28,294	20.1
Newly Industrialized Economies	12,731	16.2	25,797	18.3
World Total	78,454	100.0	141,019	100.0

*Part of the Asean total is estimated from import data.

Source: International Monetary Fund, *Direction of Trade Statistics Yearbook 1991.*

Political as well as business leaders in the region fault Japan's private sector for being more interested in buying agricultural and industrial inputs than manufactured products and using nontariff barriers to restrict imports of Asean manufactured goods. Asean observers cite Japan's distribution system and strict import specifications as factors hampering such trade. Moreover, some analysts suspect that items produced in Japanese-owned or Japanese-affiliated companies account for most of the growth in Japanese imports of manufactured goods from Asean nations; local firms reportedly continue to face difficulties exporting their products to Japan. To counter these concerns some Asean leaders have initiated programs to increase Japan's imports of manufactured goods. Indonesia, for example, has restricted the shipment of logs in an effort to promote plywood exports. Suggestions that Japan commit to a "buy-back" arrangement for goods produced by Japanese affiliates in the region have yet to gain momentum. These and other long-standing efforts to change the composition of Japan's imports from the region have resulted in only limited increases, fueling frustration among some Asean policymakers.

Although in some countries the imbalance between Japan's high value-added exports and low value imports has created tension, most Asean leaders discount their countries' current trade deficit with Japan; a number explain the imbalance as a necessary step in building their manufacturing sector. Japan's historical reliance on Asean for primary products meant that prior to the mid-1980s most members maintained a trade surplus with Japan. Since 1985 Asean has increased its imports from Japan significantly, a development many analysts attribute to Japanese investment in the region and the resulting inflow of Japanese capital and intermediate goods. Plant and machinery imports currently adding to Asean trade imbalances are seen as a step toward boosting members' export capacities. Singapore's Deputy Prime Minister Lee Hsien Loong, for example, commented in February that he did not expect his country's growing trade imbalance with Japan to become a political problem and noted that Singapore exports much of what it buys from that country in the form of final products.

Two much-debated plans pose a question of what effect regional trading blocs or some sort of regional trading group would have on Asean trade. One plan to move member nations toward a common market is seen as the latest step in Asean efforts to boost regional economic coordination and cooperation. Leaders of the six nations agreed in late January to pursue an Asean free trade area (see *JEI Report* No. 5B, Feburary 7, 1992). In part the members took this approach because of other global trade developments, such as the strengthening of the European Community trade bloc and talks to formulate a North American Free Trade Agreement. Some Asean business and political leaders have expressed fears that such regional trade tie-ups could narrow Asean's export opportunities as well as divert foreign investment from Southeast Asia.

Much more caution among regional leaders has greeted the other main proposal for economic collaboration — the East Asia Economic Caucus. Supporters of EAEC have urged the Japanese government to take a lead role in the group, which would unite Asean members plus Japan, the People's Republic of China, Taiwan, Hong Kong, South Korea, Vietnam, Myanmar and Pacific Island nations. Yet Tokyo has indicated that it is not ready to commit to the group, which some people in Japan fear would exacerbate trade tensions between that country and the United States.

One of the likely topics to be addressed as Asean leaders discuss free trade arrangements is rules of origin requirements. The question of local content requirements — frequently debated in the United States and other countries where Japan has a significant manufacturing presence — reportedly has received relatively little attention to date in Asean. This is expected to change, however, as countries try to gain more control over investment in their economies.

Asean as a Market and an Investment Site

Previous efforts to boost intra-Asean trade have had limited success, in large part because the similarity of goods produced by the six nations fostered competition rather than complementary trade. Yet many analysts expect a rapid rise in intraregional trade. This anticipated trend is in part a response to outside developments, particularly the recession affecting many industrialized nations and the inward-looking response to integration in the EC economies. But expanded intraregional trade also reflects an optimistic view of the opportunities offered by the dynamic economies of Asean and the rest of Asia. Asean members' projected growth rates for 1991, among the highest in Asia, underscore the region's attractions for trade and investment.

Many analysts question whether the economic slowdown in Japan in the year ahead will constrain Japanese businesses from investing in and importing from the region. More than a year ago a *Wall Street Journal* poll of Japanese firms with investments in Southeast Asia showed that almost half of the respondents planned to increase their investment in manufacturing or related facilities in the region in 1991. Although a number of respondents attributed plans to boost investment to labor shortages and costs in Japan, almost twice as many cited the "increasing attractiveness of the Southeast Asian market."[10] New Japanese investment commitments in Southeast Asia dropped significantly in the first half of FY 1991 compared to the previous year in line with the general trend of capital outflows from Japan. Some economists suggest, however, that competitive factors and the extent to which Japan has integrated production in the region will prevent Japan from reducing its investments in Asean and the rest of Asia.[11]

Citing reasons other than internal economic belt-tightening, Bank of Tokyo analysts have surmised that capital flows to Southeast Asia have slowed largely because Japanese and other foreign investors have finished most of their overseas expansion plans. Other observers have attributed the slowdown in part to the inability of most nations in the region to absorb further foreign investment. Inadequate infrastructure and an anticipated labor crunch are seen as problems for potential investors. In addition, Asean leaders wary of economic overheating appear to be pursuing foreign investment with greater care. Analysts caution that competition from Eastern Europe and Latin America for investor financing means that Asian nations will have to put more effort into enhancing their investment climate through such measures as clamping down on inflation, controlling deficits, removing protectionist barriers and deregulating their economies.

Another factor Japanese investors are likely to consider is the political stability of Asean nations, many of which face anticipated leadership changes in the next couple of years. In Indonesia parliamentary elections scheduled for this spring are expected to be followed by the 1993 return of President Suharto for his sixth term in office. The winning party in Thailand's March elections will take a lead role in forming that country's new government. Increased political instability could threaten the Philippines if May's presidential contest among a number of contenders results in the election of someone with only narrow popular backing.

Outlook for Japan's Political Role in the Region

Many Asean leaders recognize that Japan's economic standing in Southeast Asia carries with it a larger political role in the region, and some appear to be giving Tokyo cautious encouragement to pursue such leadership. Yet Asean observers emphasize that the six member nations intend to play a part in defining this role. Hadi Soesastro, executive director of Indonesia's Center for Strategic and International Studies, has cautioned, "All of us must come together and agree on the role we should give Japan before Japan plays that role."[12] Asean's determination not to cede decisions about a forum for security discussions, for example, was reflected in its initially hesitant response to Tokyo's July 1991 proposal that the group formalize annual ministerial meetings with "dialogue partners," including Japan, for this purpose. To a certain extent worries about a potential Japanese military presence continue to color some perceptions of Tokyo's role in the region.

Despite the concern mentioned in Singapore and the Philippines, among others, about a proposal that would allow Japan to send military units abroad to participate in United Nations-sponsored peacekeeping efforts, the thought of Japan playing a larger economic role in the region generally is accepted. One observer noted that within Asia, "Asean is the most at ease with Japan as an economic superpower and the least worried about Japan's desire to play a greater political role."[13]

Many in Asean look to Japan, in fact, to lead efforts aimed at strengthening regional economic cooperation and to represent their interests in broader discussions, including those of the Group of Seven industrialized nations. In late February Singapore's Deputy Prime Minister Lee announced that Asean would invite Japan's Minister of International Trade and Industry for discussions with the group following its annual economic meeting this year. Asean economic ministers have held similar discussions with Washington, but the invitation is a first for Tokyo and was described by Mr. Lee as "a useful step forward" for Asean.

The positive economic impact of Japanese aid, investment and trade in Asean appears to have outweighed the six nations' concerns about some aspects of Japan's involvement in the region. Yet as their interdependence in these areas evolves, both Japan and the six Asean members are likely to be challenged by new expectations and demands.

For further information, contact **Margo Grimm**.

Dan Levison provided research assistance.

Notes

[1] Paul Blustein, "Japan's 'Asian Bloc': More Illusion Than Reality," *The Washington Post*, December 8, 1991, p. H5.

[2] Testimony of Kevin Kearns, Economic Strategy Institute, before the Senate Finance Committee, subcommittee on international trade, April 15, 1991.

[3] Policy speech by Prime Minister Toshiki Kaifu, Singapore, May 3, 1991, *Asean Economic Bulletin*, July 1991, p. 90.

[4] David Arase, "U.S. and Asean Perceptions of Japan's Role in the Asian-Pacific Region" in Harry Kendall and Clara Joewono (eds.), *Japan, ASEAN, and the United States* (Berkeley, California: Institute of East Asian Studies, University of California at Berkeley, 1991), p. 270.

[5] Richard Cronin, *Japan's Expanding Role and Influence in the Asia-Pacific Region: Implications for U.S. Interests and Policy* (Congressional Research Report for Congress), September 7, 1990, pp. 23-24.

[6] *Ibid*, pp. 8, 21.

[7] Ai Leng Choo and Nayan Chanda, "Prime Minister of Malaysia Criticizes Western Model for Economic Growth," *The Wall Street Journal*, September 30, 1991.

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[9] Chia Yew Boon, Crosby Securities Pte. Ltd., cited in Steven Levingston, "Asian Export Growth Fueled by New Markets," *The Asian Wall Street Journal*, October 21, 1991, p. 4.

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JEI REPORT

A Two-Part Report: A and B

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Weak Fourth-Quarter Results Cast Shadow On Strong Annual GNP Figure

Last year economic growth in Japan came in like a lion and went out like a lamb. That assessment helps make sense of the 1991 gross national product statistics released March 19 by the Economic Planning Agency. Although the January-March inflation-adjusted annualized growth registered an astounding 8.3 percent, the expansion slowed in each of the three remaining periods. In the fourth quarter the economy posted an annualized decline of 0.2 percent, the first quarter-to-quarter drop in two-and-a-half years (see Table).

For 1991 as a whole GNP grew 4.5 percent in real terms. Although that rate of expansion was the slowest since the 4.3 percent rise registered in 1987, Japan's overall economic performance was strong compared to other industrial nations. Using gross domestic product for comparison, real U.S. output shrank 0.7 percent in 1991, while the former West Germany's inflation-adjusted GDP grew only 3.1 percent; Japan registered a 4.4 percent gain on a GDP basis. However, while the economy of the United States slowly regained its feet during 1991, the other two nations had trouble keeping their balance in the second half of the year. As a result, the American economy, as measured by GDP growth, was stronger than that of either Japan or Germany in the last two quarters of 1991.

The October-December quarter results for Japan, along with more recent indicators in both countries, suggest that the U.S. economy could outperform Japan's over the coming few months as well. In the words of the usually restrained Yutaka Kosai, head of the private Japan Economic Research Center, the fourth-quarter data represented "on the whole, extremely weak figures." Indeed, one need not look far in the statistics to find evidence of a slowdown. For example, business inventories, while accumulating more slowly than in the previous quarter, continued to increase

Japan's Real Gross National Product at Constant (1985) Prices

(in billions of yen, seasonally adjusted, quarterly totals and rates of growth at annual rates)

	1990	1991	January-March 1991	April-June 1991	July-September 1991	October-December 1991
Gross Domestic Product	n.a. (n.a.)	¥418,374.0 (4.4%)	¥414,372.6 (6.7%)	¥418,446.7 (4.0%)	¥420,211.8 (1.7%)	¥420,282.0 (0.1%)
Gross National Product	¥403,371.7 (5.2%)	421,322.5 (4.5%)	418,093.0 (8.3%)	421,003.9 (2.8%)	423,052.8 (2.0%)	422,859.2 (-0.2%)
Personal Consumption Spending	232,581.5 (4.2%)	238,740.8 (2.6%)	234,948.3 (2.3%)	238,652.2 (6.5%)	240,449.8 (3.0%)	240,667.2 (0.4%)
Private Residential Construction	22,751.4 (4.6%)	20,933.5 (-8.0%)	22,576.7 (-7.1%)	21,110.7 (-23.6%)	20,620.8 (-9.0%)	19,598.4 (-18.4%)
Private Fixed Nonresidential Investment	86,659.8 (12.4%)	91,927.4 (6.1%)	92,263.4 (9.2%)	91,559.7 (-3.0%)	92,225.3 (2.9%)	91,638.3 (-2.5%)
Change in Business Inventories	2,701.9 (-28.5%)	3,231.0 (19.6%)	3,071.8 (76.2%)	3,172.3 (13.7%)	3,420.9 (35.2%)	3,252.1 (-18.3%)
Government Current Expenditures	34,116.0 (1.9%)	35,262.8 (3.4%)	35,036.8 (6.1%)	35,595.7 (6.5%)	35,114.8 (-5.3%)	35,295.0 (2.1%)
Government Fixed Investment	25,920.8 (4.6%)	27,171.2 (4.8%)	26,143.3 (2.5%)	27,378.4 (20.3%)	27,392.6 (0.2%)	27,721.1 (4.9%)
Change in Government Inventories	86.2 (*)	-206.5 (*)	80.2 (*)	-199.8 (*)	240.8 (*)	-942.6 (*)
Net External Sector	-1,445.9 (*)	4,262.2 (*)	3,972.5 (*)	3,734.7 (*)	3,587.8 (*)	5,629.7 (*)
Exports of Goods and Services and Factor Income Received	72,810.0 (10.7%)	76,477.9 (5.0%)	76,508.5 (17.8%)	74,796.4 (-8.7%)	76,671.6 (10.4%)	77,843.7 (6.3%)
Imports of Goods and Services and Factor Income Paid	74,255.9 (12.0%)	72,215.7 (-2.7%)	72,536.0 (-2.9%)	71,061.7 (-7.9%)	73,083.8 (11.9%)	72,214.0 (-4.7%)

*Cannot be calculated or meaningless.

Source: Economic Planning Agency

rapidly. This finding suggests that further cuts in production levels are likely at Japanese firms, with attendant consequences for aggregate output. Other data were equally bleak. Despite the decline in long-term interest rates that began last July, housing construction continued to decline. Consumer spending, which accounted for 56.9 percent of real GNP in the year's final quarter, responded adversely to the economy's overall weakness and inched ahead a mere 0.4 percent on an annualized basis.

Even the one apparent bright spot in the data actually represented bad news for Japan's policymakers; the real trade surplus on a GNP basis surged in the fourth quarter, adding 0.5 percentage point to the quarterly growth rate. In other words, other factors equal, the Japanese economy in the October-December period would have shrunk approximately 2 percent on an annualized basis without the increase in net exports. However, expanding exports and shrinking imports is not a sustainable source of growth, particularly when trade frictions with major trading partners are a prime concern. Tokyo knows that a strong trade performance during a period of slow growth worldwide is political dynamite.

Most discouraging of all the fourth-quarter figures were those for plant and equipment spending. In recent years business investment has accounted for a high fraction of Japan's overall economic growth; last year it equaled 21.8 percent of real GNP. A revival of capital spending, while not absolutely necessary, would help tremendously in making Japan's recession a short one. Yet, like housing, corporate fixed investment has not responded to the lower interest rates prevailing since July, remaining at roughly the same level in 1991's four quarters; in the most recent period it declined at an annualized rate of 2.5 percent. A recent EPA survey suggested that capital spending is likely to decline further over the next six months. Surveys of corporate investment plans for FY 1992 suggest a drop over the full fiscal year as well. (For details, see *JEI Report* No. 11B, March 20, 1992.)

Based on the disappointing fourth-quarter figures, as well as the pessimistic forecasts for investment spending and other data, many — but by no means all — forecasters believe that GNP will shrink again during the January-March period. Back-to-back declines in Japan's quarterly GNP, a first since the 1973-75 oil crisis, would qualify as a recession even by U.S. standards. For Japan, where at least one period has been labeled as recessionary without even a single quarter of declining GNP, that development would come as a distinct shock.

Douglas Ostrom

Tokyo Aiming To Prime Economic Pump

Prime Minister Kiichi Miyazawa's government is rushing to flesh out its plan to prime the nation's economic pump but is encountering difficulties in developing a consensus on specific measures. While there is general agreement that something needs to be done quickly to prevent the economy from sliding deeper into recession, the Ministry of Finance remains firmly opposed to sharp increases in deficit spending — a textbook fiscal tool for stimulating the economy. In addition, speculation continues to swirl regarding when the Bank of Japan will cut the discount rate and how deep the reduction will be. Strong pressure from nearly all quarters for a quick, deep cut has encountered BOJ concerns over reigniting inflation and financial speculation. The central bank also has resisted pressures, observers say, to help defend its policymaking independence.

The private sector is waiting anxiously to see to what extent the Miyazawa government will add substance to the bare bones of the five-point economic stimulus plan announced in early March. That program specifies:

- Spending 75 to 80 percent of budgeted FY 1992 funds for public works in the first half of the fiscal year. The prime minister is asking the relevant ministries and local governments to draw up lists of projects for quick action after the new fiscal year begins April 1.

visit, the Ministry of Foreign Affairs reportedly indicated that Japan is ready to contribute its share of an IMF fund to help stabilize the value of the ruble. The Japanese foreign minister also conveyed Tokyo's backing of a proposal to remove lending limits at the European Bank of Reconstruction and Development for CIS members. EBRD agreed in January to repeal the loan ceiling, which was set at 36 million European Currency Units per year. The two foreign ministers concurred that the pending $100 million in Export-Import Bank of Japan loans should be delivered as soon as possible. Mr. Watanabe tried to impress on his counterpart, however, the importance of Russia resuming interest payments on debts owed by the former Soviet Union to Western lending nations. Mr. Kozyrev evidently said that only technical problems remain before CIS assumes joint responsibility for the debt repayments.

Although no breakthroughs were achieved, Japanese officials nevertheless were pleased with Mr. Kozyrev's visit, viewing it as a harbinger of progress. "After being deadlocked for decades, it is impossible to settle the dispute in one year," Mr. Watanabe told reporters following his meetings with the Russian foreign minister. He said Japan will take a "step-by-step" approach to resolving the Northern Territories issue. The Japanese foreign minister also expressed hope that a "certain direction" for solving the territorial dispute will be decided in time for Mr. Yeltsin's fall visit.

Barbara Wanner

Tokyo Cuts Car Export Quota

Can an extra dose of managed trade deflate pressure on Capitol Hill and in Detroit for a cap on Japan's overall share of the American car market? The Ministry of International Trade and Industry certainly hopes so. On March 19 MITI Minister Kozo Watanabe announced that the 11-year-old ceiling on U.S.-bound car exports would be lowered to 1,650,000 units at the start of April from 2,300,000 units, the annual quota since the beginning of FY 1985. Although taken as a given by trade and industry analysts in the aftermath of President Bush's early January Japan trip, the decision to tighten the restraints was not merely a reflexive response to the heightened transpacific noise level. MITI policymakers knew that a quota cut could send the wrong signals to automotive-state legislators and car and truck manufacturers in the United States (see *JEI Report* No. 5B, February 7, 1992). They also worried that such a move would spark fresh demands from France and Italy for a similar reduction in the ceiling on shipments of Japanese-made cars to the European Community, which goes into effect next year and lasts through 1998.

In the final analysis, though, the biggest drawback to the reduction option was practical: coming up with a quota figure that would score political points in the United States yet not wreak havoc with Japanese automotive manufacturers' U.S. marketing operations. Adoption of any of the export numbers deemed meaningful by Detroit, such as an annual limit of 1,300,000 cars (see *JEI Report* No. 13B, April 5, 1991) or even 1,000,000 units, apparently was ruled out from the start because of the deep shipment cuts that would be required. At the same time MITI decisionmakers no doubt recognized that setting the ceiling close to either FY 1990's actual export level — 1,849,631 — or the current fiscal year's projected tally — 1,717,692 based on a straight-line extrapolation of shipments during the April 1991-January 1992 period or 1,730,000, according to MITI's calculations — would be dismissed in the United States as an empty gesture.

Realizing that each of their other alternatives — scrapping the export ceiling altogether, maintaining the cap at 2,300,000 units or cutting the quota to FY 1991's shipment level — also had drawbacks, MITI officials went with option four and a number that would require some sacrifice by Japan's motor vehicle industry but not cause major dislocations. The reaction from Detroit was predictable. "They give the misleading impression that something meaningful is being done to reduce the U.S. trade deficit with Japan," General Motors Corp. said in a statement. Added Ford Motor Co. chairman Harold Poling, "All that has happened is that the Japanese government has proposed a voluntary level for 1992 at about the same volume their auto makers imported in the United States from Japan in 1991." Chrysler Corp. similarly argued, "They've simply set the new limit at their current sales level." The number-three U.S. automotive maker used its statement to make a new pitch to slash the quota to 1,000,000 cars a year to "get back to a level playing field for everybody."

Detroit's verdict aside, the 1,650,000-unit quota could make Japan's export restraints economically relevant for the first time since at least 1988 if, as expected, U.S. car sales reverse course this year. Japanese automotive manufacturers that build cars here — Honda Motor Co., Ltd., Toyota Motor Corp., Nissan Motor Co., Ltd., Mazda Motor Corp., Mitsubishi Motors Corp. and Fuji Heavy Industries, Ltd. (Subaru) — obviously have some flexibility to handle stronger demand for their top-selling models. Some of these same companies, however, might have to juggle their made-in-Japan product mix, choosing between maintaining exports of slower-selling but higher-profit models or supplying enough cars in high-volume, low-margin lines. Toyota, for example, could be faced with the dilemma of going after first-time car buyers and trying to improve on the 102,000 entry-level Tercels sold in 1991, or catering to buyers in the luxury class, where its Lexus line had sales last year of 71,200 units.

Of course, this problem might not materialize if prospective car buyers are turned off by the current sticker prices on Japanese nameplates. The American marketing arms of Japan's automotive makers raised prices at the start of the 1992 model year and again this month, ostensibly to cover the yen's appreciation in the intervening period. For Honda-, Toyota- and Nissan-badged cars these two increases totaled as much as $955 on a sales-weighted basis. The U.S. Big Three, in contrast, upped their prices by a sales-weighted average of $540 at introduction time but have said they will hold the line for the rest of the 1992 model year even if their Japanese competitors find it politically or economically prudent to hike prices again.

To some extent the marketing and pricing strategies adopted by Japanese car makers in the United States will depend on how MITI allocates the 1,650,000-unit export quota for FY 1992. Sources have said the ministry will not take a straight 28.3 percent off the top of each exporter's existing allotment (see Table). Instead, shipment levels will be decided company by company, reflecting such

Unofficial Quota Allocations, FY 1981-FY 1991

(in units)

Exporter	FY 1981-FY 1983 Quota	FY 1984 Quota	FY 1985-FY 1986 Quota	FY 1987 Quota	FY 1988 Quota	FY 1989-FY 1991 Quota
Toyota Motor Corp.	516,659	551,792	616,900	613,816	612,350	610,350
Nissan Motor Co., Ltd.	456,030	487,040	544,500	541,778	540,500	532,500
Honda Motor Co., Ltd.	348,631	372,338	427,000	424,865	423,850	421,850
Mazda Motor Corp.	159,282	173,468	227,800	226,661	226,100	226,100
Mitsubishi Motors Corp. (including sales to Chrysler Corp.)	112,584	122,612	195,100	194,125	193,650	193,650
Isuzu Motors Ltd. (including sales to General Motors Corp.)	16,800	49,500	120,400	119,798	119,500	124,500
Fuji Heavy Industries, Ltd.	70,014	76,250	107,600	107,062	106,800	106,800
Suzuki Motor Co., Ltd. (for sale to General Motors Corp.)	0	17,000	60,700	60,397	60,250	64,250
Daihatsu Motor Co., Ltd.	0	0	0	11,498	17,000	20,000
Total	1,680,000	1,850,000	2,300,000	2,300,000	2,300,000	2,300,000

factors as whether an exporter has been filling its quota, the manufacturer's American sales record and its export plans for the coming fiscal year, U.S. production capabilities and the firm's financial health.

Depending on how much weight is given to the last variable, Isuzu Motors Ltd. might be immune to a cut in its allocation. Fuji Heavy Industries' finances, although in better shape than Isuzu's, might qualify it for special consideration as well. MITI planners also could decide to give Isuzu a break simply because it supplies cars to GM. If that is the case, then Suzuki Motor Co., Ltd., another GM supplier, and MMC, which makes Chrysler-badged cars, should get comparable treatment. Those exceptions would shift the brunt of the quota cutback to Toyota, Nissan, Honda and Mazda, probably in that order. But as the four biggest exporters these companies no doubt knew what was in store for them even before MITI officials indicated that their allocation decisions would be guided by a checklist.

Susan MacKnight

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REPORT

A Two-Part Report: A and B

NO. 13A

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U.S.-JAPAN COMPETITION IN PHARMACEUTICALS: NO CONTEST?

SUMMARY

Pharmaceuticals are a perennial favorite of American business journalists looking for the next U.S. industrial stronghold to be tested by Japanese competitors. Perennial is the operative word. Japan's biggest pharmaceutical companies made significant strides during the 1980s, adding second- or third-generation compounds in several therapeutic classes to product portfolios previously made up largely of licensed drugs. Nonetheless, it will take another five to 10 years before any Japanese player can hope to compete in the same league as the top American and European manufacturers. In an industry where competitiveness is practically synonymous with the ability to develop and introduce a small but steady stream of innovative, profitable products, Japanese makers simply do not have enough drugs on the market or coming through the development pipeline to move up to the majors sooner.

Even the five- to 10-year time frame may be optimistic. Innovation hinges largely on the ability to finance research and development, and here Japan's pharmaceutical industry could come up short. Leading Japanese drug companies now earmark roughly the same proportion of revenues for R&D as major U.S. suppliers, but the absolute amounts are of a different order of magnitude because competitors in Japan have much smaller sales bases. Moreover, Japanese producers are having trouble sustaining the yearly increases in R&D spending that put them on a par with the U.S. industry's leaders even while the costs of developing new products continue to climb. The government's drug pricing system with its alternate-year cuts in national health insurance reimbursement rates is the major cause of the unimpressive to poor sales and earnings of top Japanese pharmaceutical companies in recent years, but stiffer competition from American and European pharmaceutical heavyweights in the local market also is taking a toll on the domestic industry's financial results.

To break out of the earnings slump first-tier Japanese pharmaceutical manufacturers are trying to expand markets in the United States and Europe for their

latest innovative products by buying or setting up production bases and distribution networks as backstops to licensing arrangements. Globalization, however, is a slow process, and the leaders of the U.S. pharmaceutical industry are not standing still. Top American drug makers, consistently the most profitable group of companies on the Fortune 500 list, continue to expand annual R&D spending by double-digit figures. Mergers have better positioned several big competitors to handle the high and increasing costs of new drug development. Other producers have forged strategic alliances to achieve the same objective. Coming on top of their own problems, moves like these will keep Japanese players in the minor league for the foreseeable future.

Unorthodox Advancement Policy

It's easy to write off U.S. manufacturers as across-the-board losers in the 1990s. After all, Japanese competitors have stripped American companies of world market leadership in industry after industry and put them on the defensive in still others; European rivals have added to this country's competitiveness problems in the same or different industries. But blanket pessimism, although understandable, is not warranted. Industry and trade analysts both in the government and outside have little trouble coming up with important industries where U.S. predominance appears unassailable at least through the end of this decade. Their candidates differ, but one industry is common to virtually all the scorecards — pharmaceuticals.

On paper pharmaceuticals should be on the casualty list as well. Drug companies in Japan got the same industrial policy leg up in the 1960s that gave steel, car, semiconductor and other current world-class Japanese manufacturers a big head start in the international catch-up process — a protected home market. Unable to own more than 50 percent of a drug manufacturing and/or marketing subsidiary in Japan from 1964 until mid-1975, many American and European makers of prescription medicines did what Tokyo expected and licensed their products to local companies for production or import and distribution. Japanese pharmaceutical producers also used the country's patent system in the adaptive way intended by industrial policy planners. Prior to 1976 patents in Japan were granted only on new processes, never on substances. That meant domestic drug firms legally could produce copies of prescription products developed by foreign suppliers simply by coming up with a different, unprotected production method.

Japan's pharmaceutical industry actually had two potentially major built-in competitive advantages: a nurturing industrial policy plus a supportive health care policy. In 1961 Tokyo created a national health insurance system that at the time generously covered prescription drug costs. And, in an unusual move, the government allowed doctors not only to prescribe but also to dispense drugs bought at negotiated prices and pocket the difference between what they charged patients and the amounts reimbursed. That combination guaranteed a fast-expanding market for prescription pharmaceuticals. The Ministry of Health and Welfare's early drug approval process helped Japanese companies capitalize on this growth since before 1967 any pharmaceutical preparation approved for sale by the Food and Drug Administration or the regulatory authority of another country did not have to be retested in Japan.

Although the alliance of industrial and health care policies made pharmaceutical companies the high fliers of Japanese industry in the 1960s and 1970s, this pairing steered manufacturers in the direction of licensing products from American and European companies rather than developing new

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drugs of their own — the prerequisite for an internationally competitive pharmaceutical industry. Innovation incentives unquestionably were in place. The drug reimbursement system, for example, was structured to favor domestically developed products at the expense of established brand names. Moreover, the spur to license foreign products inherent in Japan's drug approval process was minimized by the 1967 requirement that most preclinical work and all clinical testing performed overseas had to be repeated in Japan before a new product approval application could be submitted to MHW. Similarly, the mid-1975 end to the restrictions on inward foreign investment lessened the pressure on American and European manufacturers to license their products. In addition, the 1976 extension of legal protection to the active ingredient in a pharmaceutical compound made the development of "me-too" products less attractive. On balance, though, the system retained its bias for licensed products well into the 1980s.

This tilt notwithstanding, Japan had the nucleus of a research-oriented pharmaceutical industry by the start of the 1980s. Made up of a dozen or so first-tier companies led by Takeda Chemical Industries, Ltd., Sankyo Co., Ltd. and Fujisawa Pharmaceutical Co., Ltd. and a roughly equal number of smaller makers, this group appeared poised to put Japan at the top of the world pharmaceutical industry. The 1982-84 tally of new drug introductions, a convenient proxy for international competitiveness, had Japan first with 29 compounds, the United States next at 25, followed by West Germany with 11 substances — a flip-flop of the country rankings during the 1970s when the United States introduced 159 new drugs, West Germany brought 87 to market and Japan unveiled 73 products.

Using new drug introduction numbers as a guide to current or future competitiveness can produce misleading conclusions since the country totals say nothing about the innovativeness of the products developed. Like the third-generation cephalosporin antibiotics dotting the 1982-84 Japan list, almost all of the drugs credited to Japanese pharmaceutical manufacturers during the 1970s and in the first half of the 1980s were follow-up products, not breakthrough substances or even truly innovative compounds. That highlighted the dilemma faced by research-oriented Japanese drug makers. With R&D budgets far smaller than major American and European manufacturers, Japanese companies were forced to concentrate resources on incremental improvements in drugs already on the market — greater efficacy or improved safety, for example. But generational products, although counted as original chemical entities, do not generate the money needed to fund work on the more innovative compounds that make pharmaceutical manufacturers world competitors.

Industrial Policy Collides With Cost Containment

Any hopes Japan's research-oriented pharmaceutical companies harbored of getting off the treadmill of limited innovation and low profits in the 1980s were destroyed by a reordering of MHW health care policy priorities at the start of the decade. Medical expenditures in Japan had quadrupled during the 1960s and then more than tripled in the 1970s. Convinced that the government's national health insurance bill would continue to climb at double-digit rates without remedial action, MHW policymakers quickly zeroed in on NHI's drug reimbursement program. That program was an obvious target. By 1980 pharmaceutical preparations, including over-the-counter products as well as prescription drugs, represented at least one-third of Japan's medical expenditures. The comparable figure for the United States was a much lower 8 percent or so and edging down as a share of health care spending.

MHW's solution for Japan's seemingly runaway drug costs was to bring the government-set rates at which medical institutions and doctors are reimbursed for the drugs they use or dispense (NHI or official drug prices) into line with the wholesale prices pharmaceutical companies charge hospitals and medical practioners. The competition-caused difference was calculated at roughly 10 to 20 percent for most drugs at the beginning of the 1980s but up to 40 percent for some products. Before the gap could be attacked, however, NHI prices had to be established for every brand-name prescription drug on the market rather than for groups of products with similar therapeutic effects, the previous practice. That process, still in effect today for new drugs, yielded the highest price at which any drug

Japan. Differences among NHI prices for comparable products generally reflected premiums awarded to compounds developed in Japan, bonuses for medically useful drugs and/or credits for limited-demand but medically necessary medicines.

Armed with its list Chuikyo (Central Social Insurance Medical Council), a MHW advisory group, began to cut reimbursement prices on a brand-by-brand basis in mid-1981. By March 1990 NHI drug prices cumulatively had been slashed by a whopping 70.6 percent on average, with the initial reduction of 18.6 percent followed by drops of 4.9 percent in 1983, 16.6 percent in 1984, 6 percent in 1987, 5.1 percent in 1986, 10.2 percent in 1988 and 9.2 percent in 1990. These cuts did what MHW intended. The yearly rise in national medical expenditures was trimmed during the 1980s to the low single-digit range, and the proportion of gross national product spent on health care was kept close to 5 percent throughout the period. But cost containment also stranded Japan's pharmaceutical industry.

Production of prescription and nonprescription pharmaceuticals and related products expanded 60.7 percent between 1980 and 1990 or from ¥3.5 trillion ($15.4 billion*) to ¥5.6 trillion ($38.7 billion) (see Appendix). Not a bad showing at first glance, this gain was far smaller than the growth in output during the 1970s. Moreover, it paled in comparison with the 169.6 percent jump in U.S. shipments of drugs (broadly defined) from the larger starting base of $17.7 billion to $47.7 billion in 1990. The major cause of the slowdown is intuitively obvious: medical institutions and doctors forced drug producers to swallow most of the cuts in NHI reimbursement rates through lower wholesale prices. Part of the problem, however, was the still prominent production position of drugs licensed from overseas, which often were lower-priced compounds than products developed in-house. Another contributing factor was the continued dependence of leading Japanese pharmaceutical makers on antibiotics, infamous for their short product cycles and pricing pressures. At the same time drug companies had trouble coming up with enough new products in such growth areas as cardiovascular agents to counter the declining production value of antibiotics.

The last explanation has a certain irony. Japanese drug industry R&D spending climbed 140.2 percent over the course of the 1980s, going from ¥189.8 billion ($873.8 million) in FY 1980 to ¥456 billion ($3.2 billion) in FY 1989. This expansion raised the proportion of sales revenues invested in R&D by 1.5 percentage points to 7.5 percent for the 348 companies doing research and/or development work in the last reporting year. It also kept Japanese companies ahead in the international new drug introduction sweepstakes. Manufacturers headquartered in Japan put 84 prescription products on the market over the course of the 1985-90 period versus 72 for American companies; West German firms were a distant third (20).

Derivative products remained the norm for developed-in-Japan drugs, however. No wonder. Already the world's big spenders, the 100-plus U.S. makers of prescription pharmaceuticals accelerated their investments in ethical drug R&D in the 1980s, boosting outlays from $2 billion at the start of the decade to $7.3 billion at the end and lifting the R&D/sales ratio from 8.8 percent to 14.6 percent. The payoff from this spending volume was documented in a 1990 French study. Using the internationally recognized gauge of true innovation in the pharmaceutical industry — discoveries of new chemical entities that eventually are sold in the world's seven major markets, the author identified 33 such American-developed products in the 1975-84 period. The comparable number for European manufacturers was 39; for Japanese companies it was five. During the 1985-89 time frame, however, the U.S. industry moved into a class by itself, coming up with 14 global NCEs compared with five for its European counterpart and zero for Japan.

A 1991 International Trade Commission study provided yet another measure of the competitive gap between Japanese pharmaceutical makers and, in this case, American and European manufacturers. Looking at the largest companies in each of these three groups, researchers found that the average Japanese top-nine firm had 28 prescription drugs developed in-house in its product portfolio during the 1987-89 period. In contrast, the 11 U.S. producers surveyed marketed an average of 53 ethical compounds from their own corporate laboratories, while the nine European businesses in the sample had 52 apiece. Interestingly, though, licensed prescription drugs represented almost the same share of the average Japanese, American and European maker's product line-up — one-fourth, although the actual numbers varied (10, 16 and 18, respectively).

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*Unless otherwise noted all yen figures are converted into dollars at the relevant year's average exchange rate.

Japan's leading prescription drug manufacturers did not need the French study or the ITC survey to tell them they still had a long way to go. All they had to do was look at their own financial statements and then glance at the annual reports put out by the top U.S. drug companies. The largest pharmaceutical sales gain posted by a major Japanese maker in FY 1990 was 9.3 percent, and that increase was rung up by Yamanouchi Pharmaceutical Co., Ltd., which has perhaps the strongest development capabilities of the industry's big companies. (According to one estimate, 90 percent of Yamanouchi's sales in FY 1989 were generated by products it developed.) Moreover, reaching sales of ¥213.2 billion ($1.5 billion) in the year through March 1991 took the help of six drugs in the early stages of their product cycles plus strong-seller Gaster, a treatment for peptic ulcers and gastritis.

Sankyo, the industry's number-two producer, also did well by Japanese standards in the April 1990-March 1991 period, raising drug sales 7.7 percent to ¥292.7 billion ($2.1 billion). Its performance demonstrated that a below-average ratio of products developed in-house is not a deterrent to modest growth if a company can come up with at least one big-selling compound. For Sankyo that product was Mevalotin, a cholesterol-reducing agent, which had revenues of ¥45.6 billion ($322.8 million) in its first full year on the market.

At the other end of the scale was industry leader Takeda. Its pharmaceutical sales slipped in FY 1989 and then dropped 11.5 percent in the next accounting period to ¥368.3 billion ($2.1 billion). Takeda had to contend with several problems in FY 1990. That year's 9.2 percent average cut in NHI drug prices hit the company harder than some of its competitors because of the large number of established products in the corporate portfolio, including a fairly high proportion of licensed drugs. Moreover, new-to-the-market Pansporin T, an oral cephalosporin, and Calslot, a calcium channel blocker for hypertension, had respectable but not outstanding sales in Japan. Takeda also lost a contract from Bayer AG in April 1990 to distribute a heart medication in Japan for the big German maker.

Were it an American company Takeda would not make the list of the 10 biggest U.S. drug makers. That roster is headed by Merck & Co., Inc., which again doubled as the world industry leader in 1990 with pharmaceutical sales of $7.1 billion. Contributing to its 17.5 percent revenue jump were 18 prescription drugs in nine therapeutic classes that had worldwide sales of at least $100 million during the year, including top-selling Vasotec (an angiotensin converting enzyme or ACE inhibitor for reducing high blood pressure and treating congestive heart failure), Mevacor (a cholesterol-lowering agent) and five other antihypertensives and cardiovasculars.

Merck's 1990 sales gain was not only typical of what other big American companies achieved that year but in line with the U.S. ethical drug industry's growth during the late 1980s. For example, Bristol-Myers Squibb Co., the number-two domestic pharmaceutical manufacturer and third worldwide after the United Kingdom's Glaxo Holdings PLC, boosted drug sales 15.2 percent in 1990 to $7 billion. This total reflected revenues of $100 million-plus for 11 prescription drugs led by ACE inhibitor Capoten, which had global sales of more than $1 billion during the year.

With their huge and fast-expanding sales Merck, Bristol-Myers Squibb and other big U.S. drug manufacturers have the money to keep multiple new prescription products moving through the development pipeline and to cover the enormous costs of clinical and other testing. Merck alone invested $854 million in R&D in 1990, up from $233.9 million in 1980. Last year it spent nearly $1 billion, a figure roughly equal to 10 percent of R&D spending by U.S. ethical drug producers and 5 percent of worldwide expenditures. In 1992 the company, universally recognized for its productive use of R&D funds, expects to pour $1.1 billion into research and development, about the same amount earmarked by Glaxo. Bristol-Myers Squibb and Johnson & Johnson have comparably sized R&D budgets. Although part of both companies' budgets goes for work outside the pharmaceutical business, spending on prescription drug R&D represented 14.4 percent of the number-two U.S. maker's ethical pharmaceutical sales in 1990 and 15.3 percent of Johnson & Johnson's.

More money does not guarantee successful innovation in the ethical drug industry, but it certainly gives competitors a better chance of coming up with the next blockbuster product instead of a new version of an existing drug. By this benchmark Japan's research-oriented makers appear doomed. While some fairly sizable funding increases during the late 1980s put most major Japanese companies on an equal footing with top U.S. pharmaceutical makers in terms of R&D/ethical drug sales ratios, Japan's eight largest drug manufacturers together invested only ¥223.5 billion ($1.6 billion) in research and development in FY 1990. Moreover, part of that money went for projects in other business lines.

Makers of prescription products could get some help from the latest changes in the NHI drug pricing system. Frustrated by the continuing 20 percent-plus spread between reimbursement rates and actual wholesale prices — a difference MHW pegged in 1990 at ¥1.3 trillion ($9.1 billion) a year, Chuikyo recommended a revamp of the price adjustment mechanism in May 1991. Until then a so-called 90 percent bulk-line method had been used to determine changes in NHI prices for most drugs already on the market. Under that formula if there were 100 different selling prices for a particular product, the ninetieth highest price was adopted as the official price. To ensure that future NHI prices for established drugs more closely tracked market prices the MHW advisory group opted for the use of a drug's actual weighted-average price as its official price.

Along with this methodology Chuikyo proposed that the NHI price for a specific product not be cut if the drug's actual weighted-average price were no more than 15 percent below the reimbursement rate. Prescription drug manufacturers, both foreign and Japanese, had fought hard for pricing relief of this type, arguing that at a minimum producers should be allowed some margin for inflation. Their idea of a reasonable safety zone was 20 percent, however. To boot, the MHW panel recommended that the 15 percent figure be lowered in three steps to 10 percent in 1998.

Chuikyo's suggested price-setting formula for new prescription drugs earned more applause from the Japan Pharmaceutical Manufacturers Association and its American counterpart. Although comparative data still would be used to establish basic NHI prices for new products, a premium of up to 20 percent would be added for genuinely innovative drugs, whether developed in Japan or overseas. Bonuses worth a maximum of 3 percent apiece also would be applied to "useful" new drugs — for example, drugs exhibiting fewer side effects than products already on the market — and orphan drugs.

The advisory group's price adjustment formula was used to calculate the April 1992 NHI prices for existing drugs. That process yielded a bigger cut than pharmaceutical manufacturers had anticipated, 8.1 percent on average. Analysts do not know for certain why the reduction exceeded the expected 7 percent or so decrease, but they have one candidate: new drug distribution practices that went into effect a year ago. As a result of those changes — part of a broader, U.S.-inspired effort by the Fair Trade Commission to streamline Japan's distribution system and make it more transparent, the power to negotiate drug prices with medical institutions and doctors basically shifted from manufacturers to wholesalers.

Previously drug companies determined the prices at which wholesalers resold products to end users. Now inexperienced wholesalers are making those decisions. They reportedly are being maneuvered by the medical establishment into pricing products below what had been manufacturers' resale quotes, with the deepest discounts occurring in those therapeutic classes like antibiotics where considerable pricing pressures existed even under the old system. The apparent result over the last year was a bigger-than-realized decline in the actual weighted-average price of a broad range of prescription medicines, which pulled down NHI reimbursement rates for FY 1992. That experience does not bode well for an end to the downward price spiral that has constrained the Japanese industry's drug development efforts. It also calls into question the competitive value of the revised system for setting NHI prices for new pharmaceutical products.

Breaking In ...

Cost containment unquestionably is the Japanese pharmaceutical industry's number-one competitive problem, but aggressive American and European drug makers also are making it hard for research-oriented companies to generate money at home for innovation. Freed from the restraints that hamstrung their early activities, foreign multinationals have built a major presence in the world's second-largest drug market over the last decade. Today they have a direct stake of at least 20 percent in Japan's prescription and over-the-counter drug business, plus an additional but hard-to-quantify share of the market through licensing arrangements. Virtually to a company, though, major American, German, Swiss and British producers regard their current slice of Japanese ethical drug sales (2.3 percent at most, according to one study of the 1989 market) as just a beginning.

Leading international pharmaceutical manufacturers used the 1980s to complete the first stage of their strategic plans for becoming major players in the Japanese market and concurrently to launch the next phases. For companies that went into Japan during the period of restricted investment opportunities or even before then, step one involved converting joint venture manufacturing and/or marketing operations into wholly owned subsidiaries or gaining management control of joint ventures while making provision for future full ownership. Bristol-Myers, Pfizer Inc. (the number-five U.S. pharmaceutical maker), Warner-Lambert Co. (another top-10 American drug manufacturer), Glaxo and Switzerland's Ciby-Geigy AG were among the firms buying out Japanese partners. For their part SmithKline Beckman Corp. and Monsanto Co.'s G.D. Searle & Co. pharmaceutical unit both arranged to take over their joint ventures in the 1990s. Merck's phase-one strategy was the most creative. Instead of buying out its longtime production and sales joint venture partner, Banyu Pharmaceutical Co., Ltd., the world industry leader acquired a 50.02 percent stake in the midsized drug maker in October 1984.

Gaining complete or majority control of their Japanese operations gave foreign manufacturers the freedom to pursue relationships with other drug makers in Japan, but in divorcing partners that were competitors American and European producers often lost their distributors. That marked the start of phase two for most companies: building or expanding in-house sales organizations. Multinationals like Pfizer and Germany's Hoechst AG that went the direct distribution route from the start or offshore suppliers that used a combination of direct sales and distributors, such as Bayer and Switzerland's Sandoz Ltd., had demonstrated that foreign companies could recruit a Japanese marketing team. The main problems encountered by these firms as well as Schering-Plough Corp., Eli Lilly and Co. and other foreign manufacturers that established their own sales networks during the 1980s were the expense and the time required to develop competitive in-house marketing organizations.

Industry analysts say a pharmaceutical maker needs a minimum of 800 sales people to have a market impact in Japan and a marketing force of at least 1,000 to cover hospitals and doctors across Japan as effectively as Takeda, Sankyo, Yamanouchi and other major Japanese manufacturers. Merck reportedly has crossed the second threshold, while Bayer — which shares the foreign market leadership position in Japan with the top U.S. drug company — and Pfizer are at or near the first one. With anywhere from 500 to 700 marketing representatives on board now and additional people being hired, competitors like Glaxo, Ciba-Geigy, Sandoz, Hoechst, Schering-Plough and Upjohn Co. are within striking distance. To achieve the necessary market coverage, however, a few firms in this category as well as foreign companies with smaller in-house sales staffs use Japanese distributors for part or all of their product line.

While expanding their marketing units, major American and European drug manufacturers also are strengthening their R&D presence in Japan. A 1990 MHW survey indicated that 29 of 49 foreign-affiliated pharmaceutical companies in Japan already had local research centers and that six others planned similar facilities. Most of these laboratories conduct or oversee clinical work on new drugs developed overseas preparatory to filing a product approvai application with the ministry. (While Japan has accepted foreign clinical test findings in principle since mid-1985, tests must be repeated in Japan if the results can be affected by racial differences — absorption, metabolism and excretion tests, dosage determination tests and comparative clinical trials.) Nevertheless, an increasing number of foreign-owned facilities, like the one Merck will open this spring for research on cancer and cardiovascular and infectious diseases, are geared for basic and applied research or development work.

... and Out

With aggressive foreign multinationals compounding their money-making troubles at home, Japan's leading drug manufacturers took a harder look in the second half of the 1980s at the largely unexplored area of direct sales in the United States and Europe. Until then pharmaceutical makers felt they had no option other than granting American and European drug companies production and sales rights to their most innovative products. The difficulties of navigating the rigorous FDA new drug approval process in this country and comparable regulatory hurdles in Europe plus the cost and time problems associated with organizing adequate marketing networks overseas simply overwhelmed corporate marketing strategists.

Yet, as Japanese pharmaceutical makers first discovered when they assigned offshore manufacturing and marketing rights to their cephalosporin antibiotics in the 1970s, licensing arrangements also have a major drawback: they are more profitable for the licensee than the product's developer. Take, for example, Herbesser, a calcium antagonist developed by Tanabe Seiyaku Co., Ltd. The world's leading treatment for hypertension and angina, it is marketed in this country by Marion Merrell Dow Inc. as Cardizem. U.S. sales totaled $743 million in 1990 alone, but Japan's eighth-largest drug maker saw little of this money or what the drug made in the nearly 100 other countries outside Japan in which it is sold

Japan's technology trade figures quantify the disadvantages of licensing. Despite a steady increase in the number of drugs licensed for foreign sale during the 1980s, royalties and fees earned by Japan's pharmaceutical industry merely expanded from ¥8.3 billion ($36.3 million) in FY 1981 to ¥18.9 billion ($132.4 million) in FY 1989. To make matters worse Japanese drug makers continued to pay out more for products licensed from American and European manufacturers than they earned after going into the black in FY 1986 and FY 1987. With payments running at ¥21.5 billion ($150.4 million) in the April 1989-March 1990 period, the difference was not much smaller than in FY 1981 when outlays totaled ¥11.1 billion ($48.6 million). Even the addition of exports to licensees of bulk ingredients, such as diltiazem (Herbesser's generic name), or ready-to-dispense drugs did not alter the fact that Japanese drug companies needed an overseas presence if they were to make real money in the international market.

Takeda made the earliest move in this direction, forming an equally owned venture with Abbott Laboratories in 1977 to develop and sell prescription products in North America based on the top Japanese drug maker's research. The mainstay of TAP Pharmaceutical Inc. is Lupron, marketed on introduction in 1985 as a treatment for advanced prostate cancer and since 1990 as a treatment for endometriosis. Takeda's subsequent U.S. move was to open a plant in Wilmington, North Carolina in 1986 for the production of vitamin B_1 and later vitamin C, both of which are marketed in the United States and Canada by a wholly owned American subsidiary.

Although it was the first major Japanese pharmaceutical manufacturer to venture abroad, Takeda has moved more cautiously than some of its rivals in both the United States and Europe, where the company's activities are limited to marketing arrangements for Lupron (known there as Enantone) with German, French and Italian firms. Yamanouchi, for instance, built a plant in Dublin, Ireland for bulk shipments of its Gaster (famotidine) ulcer medicine to licensee Merck for European sale starting in mid-1989 and American marketing at the beginning of 1990. In 1991 the Irish facility added bulk production of Perdipine (nicardipine), a calcium antagonist. The same year the number-three Japanese pharmaceutical maker bought the drug division of a small Dutch company to give it a foothold in the European market similar to the stake it had acquired in the United States through the 1989 purchase of Shaklee Corp. While Shaklee makes nutritional supplements rather than prescription drugs, the buyout gave Yamanouchi access to American management skills, a research center, a manufacturing facility and a distribution network, all of which can be adapted for the production and sale of ethical drugs.

Acquisitions also have given Fujisawa European and American business bases. The number-four Japanese drug company owns a 74 percent interest in Klinge Pharma GmbH, a German developer and maker of cardiovascular and respiratory system agents that has a sales force of about 1,000 people. Klinge's European manufacturing operations will be supplemented by a Fujisawa plant nearing completion in Ireland; that facility will be used to formulate and package FK-506, a promising immunosuppressant, for the American and European markets. The center of the Japanese manufacturer's U.S. operations is the former LyphoMed Inc. The suburban Chicago, Illinois-headquartered producer of injectable drugs used in hospitals was bought in a two-step process completed in 1989. This purchase not only supplied Fujisawa with three domestic plants and an independent American research capability but also boosted its existing U.S. sales and marketing force to about 300 people.

For its part Sankyo acquired a midsized German pharmaceutical company, Luitpold-Werk AG. That 1990 move also provided entree to the American market through Luitpold's New York production and sales subsidiary. But this and the similar overseas steps taken by Sankyo's at-home rivals merely position leading Japanese research-oriented pharmaceutical companies for possible future international growth. The infrastructure now in place in the United States and Europe, while a start, simply is not extensive enough to give a significant near- or medium-term boost to the financial position of top Japanese drug makers. In addition, potentially big-selling current prescription products already have been licensed to foreign companies for international sale, including Sankyo's Mevalotin, which will be marketed outside Asia by Bristol-Myers Squibb. That also apparently is true for most of the Japanese-developed ethical drugs now in the testing phase.

Moreover, while Japan's major prescription drug manufacturers are building foreign production and/or sales bases, American and European multinationals are becoming stronger competitors. A merger wave took place during the 1980s, driven in large part by the high and rising cost of new drug development. (According to the most widely quoted estimate, developing a new chemical entity in the United States and bringing it to market costs $231 million if the R&D charges associated with failed drugs are included.) The 1989 merger of Squibb Corp. with Bristol-Myers Co., both top-10 U.S. drug manufacturers on their own, headed combinations that included in the same year the acquisition of SmithKline Beckman by the United Kingdom's Beecham Group plc, another major international player; the purchase of medium-sized A.H. Robins Co. by American Home Products Corp., the number-two American maker until Squibb and Bristol-Myers merged; and the takeover of midsized Marion Laboratories Inc. by Dow Chemical Co.'s Merrell Dow unit. Merck matched these strategic moves with one of its own, forming an equally owned joint venture with E.I. duPont de Nemours & Co., Inc. in 1990 to discover, develop and market prescription drug products in several therapeutic classes. Other major American and European drug makers also have merged, formed research alliances, licensed-in products or signed comarketing deals for certain products. Moves like these will make it hard if not possible for Japan's top ethical pharmaceutical companies to enter the international major league of drug manufacturers.

For further information, contact **Susan MacKnight.**

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

APPENDIX

Table 1: **Japan's Pharmaceutical Market, 1980-90**

	1980	1985	1986	1987	1988	1989	1990
			(in millions of yen)				
Production	¥3,482,177	¥4,001,807	¥4,280,732	¥4,825,398	¥5,059,459	¥5,502,271	¥5,595,435
Total Exports* (f.o.b.)	n.a.	30,487	30,447	30,412	28,216	27,351	35,746
Total Imports* (c.i.f.)	262,363	308,954	329,741	355,496	376,006	417,861	469,486
Trade Balance	n.a.	-278,467	-299,294	-325,084	-347,790	-390,510	-433,740
Exports to United States* (f.o.b.)	n.a.	2,815	3,019	1,655	1,101	1,221	1,899
Imports from United States* (c.i.f.)	71,243	120,007	112,885	104,063	101,007	109,418	124,425
Trade Balance	n.a.	-117,192	-109,866	-102,408	-99,906	-108,197	-122,526
Total Exports as Percent of Production	n.a.	0.8%	0.7%	0.6%	0.6%	0.5%	0.6%
Total Imports as Percent of Apparent Domestic Consumption	n.a.	7.2%	7.2%	6.9%	7.0%	7.1%	7.8%
Exports to United States as Percent of Production	n.a.	0.1%	0.1%	--	--	--	--
Imports from United States as Percent of Apparent Domestic Consumption	n.a.	2.8%	2.5%	2.0%	1.9%	1.9%	2.1%
			(in millions of dollars**)				
Production	$15,358	$16,776	$25,402	$33,361	$39,481	$39,883	$38,645
Total Exports* (f.o.b.)	n.a.	127	179	208	220	199	246
Total Imports* (c.i.f.)	1,152	1,286	1,939	2,435	2,934	3,044	3,236
Trade Balance	n.a.	-1,159	-1,760	-2,227	-2,714	-2,845	-2,990

*Covers only pharmaceutical products in final, ready-to-use, form. The much bigger two-way trade in bulk ingredients is excluded.

**The following average exchange rates were used to convert the yen figures into dollars:

Production - 1980, ¥226.74; 1985, ¥238.54; 1986, ¥168.52; 1987, ¥144.64; 1988, ¥128.15; 1989, ¥137,96; and 1990, ¥144.79.
Exports - 1980, ¥227.67; 1985, ¥240.29; 1986, ¥169.99; 1987, ¥145.90; 1988, ¥128,13; 1989, ¥137.34; and 1990, ¥145.10.
Imports - 1980, ¥227.85; 1985, ¥240.17; 1986, ¥170.08; 1987, ¥146.01; 1988, ¥128.15; 1989, ¥137.26; and 1990, ¥145.09.

Source: Ministry of Health and Welfare, Pharmaceutical Affairs Bureau, *Yakuji Kogyo Seisan Dotai Tokei Nenpo*.

Table 2: **Production of Pharmaceuticals in Japan, 1980-90***

(in millions of yen)

	1980	1985	1986	1987	1988	1989	1990
Cardiovascular Agents	¥377,757	¥519,683	¥563,301	¥648,509	¥695,987	¥770,008	¥828,331
Antibiotics and Anti-Infectives	814,320	690,505	683,361	733,974	702,485	724,523	624,117
Central Nervous System Agents	344,197	383,855	430,516	494,766	517,456	559,001	548,292
Gastrointestinal Agents	256,830	353,799	372,044	436,969	458,256	522,300	521,601
Miscellaneous Metabolic Agents	363,950	314,132	328,629	365,535	396,390	436,562	465,934
Dermatological Agents	197,984	239,679	261,030	284,322	303,865	324,902	325,928
Vitamins	216,249	238,541	243,712	252,574	267,369	282,518	286,811
Respiratory System Agents	79,960	141,781	166,904	202,518	222,294	248,310	265,383
Diagnostic Agents	30,164	65,019	72,236	110,548	145,160	166,617	202,235
Blood Pressure and Similar Medicines	82,690	121,405	132,270	144,597	151,937	176,569	178,690
Nutrients and Tonics	85,704	126,021	129,274	146,571	151,937	167,686	172,193
Biologicals	114,396	153,359	157,887	114,550	145,160	159,805	171,651
Antitumor Agents	107,351	138,601	160,822	144,597	148,853	166,517	164,151
Chemotherapy Drugs	29,487	59,020	82,269	109,622	107,162	118,963	162,053
Herb Medicines	33,749	75,273	93,233	110,548	117,602	137,770	161,756
Other Pharmaceutical Preparations	347,389	381,134	403,244	522,600	527,546	540,220	516,309
Total	3,482,177	4,001,807	4,280,732	4,825,398	5,059,459	5,502,271	5,595,435
of which:							
Prescription	2,978,437	3,383,710	3,649,842	4,141,820	4,309,824	4,676,456	4,720,333
Domestic Drugs	1,981,278	2,386,022	2,547,249	2,897,396	2,991,784	3,230,933	3,324,858
Imported Drugs	997,159	997,688	1,102,593	1,244,424	1,318,040	1,445,523	1,395,475
Nonprescription	503,740	618,096	630,890	683,577	749,634	825,815	875,103

Note: Imported prescription drugs are compounds made primarily from imported ingredients, including raw powder, undiluted solutions and bulk goods.

*Ranked in terms of 1990 output.

Source: Ministry of Health and Welfare, Pharmaceutical Affairs Bureau, *Yakuji Kogyo Seisan Dotai Tokei Nenpo.*

Table 3: **Japan's Exports of Pharmaceuticals, 1980-90**

(in millions of yen)

	1980	1985	1986	1987	1988	1989	1990
Total Exports	n.a.	¥30,487	¥30,447	¥30,412	¥28,216	¥27,351	¥35,746
By Major Market*							
People's Republic of China	n.a.	3,262	4,616	6,356	7,085	4,931	6,987
Taiwan	n.a.	4,913	5,406	4,888	5,074	5,008	4,909
Hong Kong	n.a.	1,875	2,363	2,386	2,480	2,320	2,762
East Germany	n.a.	n.a.	n.a.	673	1,037	2,002	2,295
South Korea	n.a.	1,360	1,324	1,288	1,616	1,525	2,005
United States	n.a.	2,815	3,019	1,655	1,101	1,221	1,899
West Germany	n.a.	1,867	1,952	1,917	638	768	1,395
By Major Product Line*							
Antibiotics and Anti-Infectives	n.a.	6,161	6,062	7,546	7,341	5,867	6,418
Diagnostic Agents	n.a.	5,816	5,465	5,312	3,334	3,559	5,999
Nutrients and Tonics	n.a.	2,057	3,418	2,933	3,695	3,454	5,059
Antitumor Agents	n.a.	1,101	1,542	1,718	1,456	1,851	2,223
Miscellaneous Metabolic Agents	n.a.	1,257	1,329	1,185	1,033	884	2,011
Exports to the United States by Major Product Line							
Antibiotics and Anti-Infectives	n.a.	409	342	n.a.	n.a.	208	441
Diagnostic Agents	n.a.	1,365	1,539	643	224	351	750
Nutrients and Tonics	n.a.	324	549	539	382	489	432
Miscellaneous Metabolic Agents	n.a.	130	177	140	98	n.a.	107

Note: These export figures cover only pharmaceutical products in final, ready-to-use, form. Excluded are exported bulk ingredients.

*Ranked in terms of 1990 trade.

Source: Ministry of Health and Welfare, Pharmaceutical Affairs Bureau, *Yakuji Kogyo Seisan Dotai Tokei Nenpo.*

Table 4: **Japan's Imports of Pharmaceuticals, 1980-90**

(in millions of yen)

	1980	1985	1986	1987	1988	1989	1990
Total Imports	¥262,363	¥308,954	¥329,741	¥355,496	¥376,006	¥417,861	¥469,486
of which: Prescription	n.a.	302,602	321,627	348,235	366,646	407,441	457,505
By Major Supplier*							
United States	71,243	120,007	112,885	104,063	101,007	109,418	124,425
West Germany	52,161	59,506	71,161	80,046	85,167	100,316	108,587
Great Britain	13,727	29,883	36,825	51,171	41,954	50,109	55,617
Switzerland	29,309	18,101	25,405	26,704	36,653	35,627	39,739
By Major Product Line*							
Diagnostic Agents	3,257	45,130	65,331	83,677	91,841	112,882	144,856
Hormones	28,908	32,987	36,827	40,066	41,714	49,295	66,461
Biologicals	15,662	81,574	69,608	63,204	61,705	66,698	64,561
Antibiotics and Anti-Infectives	88,880	37,658	32,022	33,080	42,669	43,843	37,694
Sensory Organ Agents	n.a.	9,381	11,259	13,368	16,902	19,739	23,617
Imports from the United States by Major Product Line							
Diagnostic Agents	n.a.	15,191	19,550	24,837	25,759	31,979	48,900
Hormones	n.a.	8,955	9,624	9,999	9,609	10,723	11,278
Biologicals	n.a.	73,926	61,801	51,944	49,671	51,184	48,625
Antibiotics and Anti-Infectives	n.a.	7,713	8,321	8,909	8,989	10,699	10,343
Sensory Organ Agents	n.a.	91	146	117	1,053	57	287

Note: These import figures cover only pharmaceutical products in final, ready-to-use, form. Excluded are imported bulk ingredients. Their total is indicated on Table 2.

*Ranked in terms of 1990 trade.

Source: Ministry of Health and Welfare, Pharmaceutical Affairs Bureau, *Yakuji Kogyo Seisan Dotai Tokei Nenpo.*

Table 5: **R&D Spending by Japan's Pharmaceutical Industry**

Expenditures on Disbursement Basis

	FY 1980	FY 1985	FY 1986	FY 1987	FY 1988	FY 1989
Total (in millions of yen)	¥189,838	¥341,880	¥341,978	¥380,701	¥416,220	¥455,950
Total (in thousands of dollars*)	$873,823	$1,546,339	$2,139,502	$2,751,724	$3,245,127	$3,192,257
Share of Sales	6.00%	7.04%	6.89%	6.96%	6.94%	7.50%

Note: The data were converted into dollars at the following average exchange rates: FY 1980, ¥217.25; FY 1985, ¥221.09; FY 1986, ¥159.84; FY 1987, ¥138.35; FY 1988, ¥128.26; and FY 1989, ¥142.83.

Spending by Sales Volume, FY 1989

Sales Volume (million yen)	Number of Companies	Total Sales (million yen)	Net Operating Income (million yen)	Total R&D Personnel	Total R&D Spending (million yen)	Share of Sales*
Total	575	¥6,250,800	¥657,439	26,040	¥455,950	7.50%
Under ¥100	78	5,000	71	7	26	6.40
¥100-¥1,000	209	83,700	4,078	271	1,713	4.93
¥1,000-¥10,000	199	615,300	50,410	3,407	32,926	5.75
¥10,000 or More	89	5,546,900	602,880	22,355	421,286	7.70

*For those companies performing R&D.

Type of R&D Spending by Size of Capital, FY 1989

Capital (million yen)	Number of Companies	R&D Spending (million yen)				Distribution		
		Total	Basic	Applied	Development	Basic	Applied	Development
Total	348	¥455,950	¥95,286	¥122,195	¥238,470	20.9%	26.8%	52.3%
¥5-¥10	10	131	9	8	114	6.7	6.0	87.3
¥10-¥100	195	18,243	3,103	3,501	11,640	17.0	19.2	63.8
¥100-¥1,000	77	41,041	8,933	13,345	18,762	21.8	32.5	45.7
¥1,000-¥10,000	45	106,444	12,373	31,326	62,744	11.6	29.4	58.9
¥10,000 or More	21	290,092	70,867	74,015	145,210	24.4	25.5	50.1

Source: Management and Coordination Agency, Statistics Bureau, *Report on the Survey of Research and Development*.

Table 6: **Financial Profiles of Japan's Major Pharmaceutical Makers, FY 1988-FY 1990**

(in millions of yen)

	Worldwide Pharmaceutical Sales	Total Sales	Share of Non-Japan Sales	Total Operating Income	Total R&D Spending	Share of Total Sales
Takeda Chemical Industries, Ltd.						
FY 1988	¥420,041	¥585,015	5%	¥65,244	¥43,868	7.5%
FY 1989	416,257	587,763	6	60,127	48,500	8.3
FY 1990	368,264	550,871	9	54,964	49,400	9.0
Sankyo Co., Ltd.						
FY 1988	266,861	308,510	2	28,462	23,495	7.6
FY 1989	271,788	313,731	4	29,707	24,785	7.9
FY 1990	292,706	336,311	5	40,933	24,785	7.4
Yamanouchi Pharmaceutical Co., Ltd.						
FY 1988	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
FY 1989	195,051	195,051	8	46,002	22,245	11.4
FY 1990	213,183	213,183	9	47,302	26,197	12.3
Fujisawa Pharmaceutical Co., Ltd.						
FY 1988	192,995	208,643	5	11,057	22,318	10.7
FY 1989	192,192	210,303	7	10,444	24,404	11.6
FY 1990	201,744	221,209	8	11,241	27,578	12.5
Eisai Co., Ltd.						
FY 1988	173,362	186,411	4	29,706	24,732	13.3
FY 1989	182,676	197,274	4	29,866	27,400	13.9
FY 1990	192,341	205,493	4	28,969	29,400	14.3
Shionogi & Co., Ltd.						
FY 1988	183,666	216,077	1	25,925	20,420	9.5
FY 1989	179,367	213,223	1	22,518	22,714	10.7
FY 1990	182,233	215,790	1	12,856	24,478	11.3
Daiichi Pharmaceutical Co., Ltd.						
FY 1988	166,734	166,734	5	39,091	17,159	10.3
FY 1989	169,257	169,257	7	37,798	18,480	10.9
FY 1990	178,045	178,045	8	32,011	20,976	11.8
Tanabe Seiyaku Co., Ltd.						
FY 1988	167,165	196,665	17	21,533	16,136	8.2
FY 1989	164,800	193,200	18	11,706	17,600	9.1
FY 1990	170,990	200,223	18	11,203	20,642	10.3

Notes: Pharmaceuticals cover both ethical and over-the-counter drugs.
For some companies the FY 1988 figure for worldwide pharmaceutical sales was partially estimated.
The data can be converted into dollars using the following average exchange rates: FY 1988, ¥128.26; FY 1989, ¥142.83; and FY 1990, ¥141.28.

Source: Toyo Keizai Inc., *Japan Company Handbook,* and company reports.

Table 7: **U.S. Pharmaceutical Market, 1980-90**

(in millions of dollars)

	1980	1985	1986	1987	1988	1989	1990
Total Shipments	$17,674.3	$29,718.8	$32,110.3	$35,283.4	$39,327.7	$42,687.4	$47,650.3
Total Exports (f.a.s.)	n.a.	2,671.0	3,087.0	3,229.0	3,934.0	4,346.0	5,062.0
of which:							
Pharmaceutical Preparations	n.a.	691.0	648.0	676.0	858.0	974.0	1,258.0
Medicinals and Botanicals	n.a.	1,465.0	1,815.0	1,982.0	2,463.0	1,797.0	1,921.0
Biologicals	n.a.	516.0	623.0	571.0	614.0	837.0	973.0
Diagnostic Substances	n.a.	n.a.	n.a.	n.a.	n.a.	739.0	909.0
Total Imports (Customs)	n.a.	1,896.0	2,322.0	2,795.0	3,485.0	3,513.0	3,863.0
of which:							
Pharmaceutical Preparations	n.a.	216.0	157.0	164.0	199.0	868.0	1,103.0
Medicinals and Botanicals	n.a.	1,517.0	2,007.0	2,468.0	3,056.0	2,336.0	2,282.0
Biologicals	n.a.	163.0	158.0	164.0	230.0	191.0	271.0
Diagnostic Substances	n.a.	n.a.	n.a.	n.a.	n.a.	118.0	207.0
Trade Balance	n.a.	775.0	765.0	434.0	449.0	833.0	1,199.0
Exports to Japan (f.a.s.)	n.a.	n.a.	n.a.	n.a.	n.a.	915.0	877.0
Imports from Japan (Customs)	n.a.	n.a.	n.a.	n.a.	n.a.	418.0	360.0
Trade Balance	n.a.	n.a.	n.a.	n.a.	n.a.	497.0	517.0
Total Exports as Percent of Shipments	n.a.	9.0%	9.6%	9.2%	10.0%	10.2%	10.6%
Total Imports as Percent of Apparent Domestic Consumption	n.a.	6.6%	7.4%	8.0%	9.0%	8.4%	8.3%

Note: The trade data for the 1985-88 period and the 1989-90 period are not directly comparable because of the switch in 1989 to the Harmonized Commodity Description and Coding System.

Table 8: **U.S. Shipments of Pharmaceuticals, 1980-90**

(in millions of dollars)

	1980	1985	1986	1987	1988	1989	1990
Central Nervous System and Sensory Organ Agents	$2,821.0	$5,737.6	$5,946.0	$5,740.5	$6,172.7	$6,441.3	$7,290.7
Antibiotics and Anti-Infectives	1,778.3	3,386.2	3,821.0	4,024.9	4,593.6	4,936.2	5,612.1
Cardiovascular Agents	1,176.4	3,170.9	3,570.3	3,795.9	4,449.9	4,874.9	5,321.3
Gastrointestinal and Genitourinary Agents	1,232.3	1,875.9	1,864.5	2,954.8	3,860.8	4,363.0	4,940.4
Respiratory System Agents	1,239.5	2,202.4	2,492.2	2,811.4	3,224.0	3,286.2	3,917.5
Hormones and Antitumor Agents	1,209.7	2,110.2	2,140.6	1,994.9	2,071.2	2,507.4	2,784.4
Vitamins and Nutrients	1,876.5	2,291.2	2,665.9	2,570.7	2,538.5	2,672.4	2,662.7
Dermatological Agents	728.1	1,213.3	1,327.3	1,288.3	1,388.5	1,451.7	1,548.6
Veterinary Preparations	546.3	817.7	853.7	997.1	1,051.5	1,071.1	1,022.8
Unspecified Preparations	306.2	544.6	590.3	431.7	0.0	0.0	0.0
Pharmaceutical Preparations of which:	12,914.3	23,350.0	25,271.9	26,610.3	29,350.7	31,604.2	35,100.6
Prescription	7,814.2	15,110.0	16,468.1	17,756.4	20,014.6	22,171.3	25,109.5
Nonprescription	4,530.2	7,177.8	7,673.5	7,807.7	8,814.7	8,726.5	9,291.1
Bulk Shipments	263.8	517.6	540.0	614.5	521.4	706.5	699.9
Medicinals and Botanicals*	3,158.0	3,347.3	3,397.2	4,224.4	4,948.1	5,392.6	5,788.9
Biologicals**	1,602.0	1,328.3	1,419.0	1,765.3	1,966.0	2,219.9	2,526.8
Diagnostic Substances	n.a.	1,693.2	2,022.2	2,683.4	3,062.9	3,470.7	4,234.0
Total Shipments	17,674.3	29,718.8	32,110.3	35,283.4	39,327.7	42,687.4	47,650.3

*Medicinals are made up largely of bulk organic and inorganic medicinal chemicals and their derivatives, while botanicals consist mainly of bulk botanical drugs and herbs.

**Biologicals include vaccines, antigens, antitoxins and toxoids as well as serums, plasmas and other blood derivatives. The 1980 figure includes diagnostic substances.

Sources: Department of Commerce, Bureau of the Census, *Current Industrial Reports: Pharmaceutical Preparations, Except Biologicals* (data on pharmaceutical preparations); Department of Commerce, Bureau of the Census, *Annual Survey of Manufactures* (other data).

Table 9: **R&D Spending by the U.S. Pharmaceutical Industry, 1980 and 1989**

(in millions of dollars unless otherwise indicated)

	1980	1989
Expenditures		
Total R&D Spending	$1,976.7	$7,330.0
Company-Financed Spending	1,971.6	7,327.9
Spent in the United States	1,544.1	6,019.3
Spent Abroad	427.5	1,308.6
U.S. Government Grants and Contracts for Company-Conducted R&D	5.1	2.1
Total Sales of Ethical Pharmaceuticals	22,513.0	50,139.5
R&D Spending as Share of Sales	8.8%	14.6%
Distribution of R&D Money Spent in the United States by Product Class		
Total Spending	$1,544.1	$6,019.3
Cardiovasculars	18.9%	23.0%
Central Nervous System and Sense Organs	16.2	15.4
Neoplasms, Endocrine System and Metabolic Diseases	14.3	15.2
Anti-Infectives	17.4	15.0
Respiratory	4.8	6.1
Biologicals	3.1	4.7
Gastrointestinal and Genitourinary System	6.4	4.6
Dermatologicals	3.2	2.3
Diagnostics (in vitro)	1.0	2.0
Vitamins	2.3	0.2
Other Products for Human Use	6.9	8.0
Veterinary Preparations	5.1	3.3
Veterinary Biologicals	0.4	0.2
Distribution of R&D Money Spent in the United States by Function		
Total Spending	$1,544.1	$6,019.3
Clinical Evaluation: Phases I, II, III	19.8%	26.7%
Biological Screening and Pharmacological Testing	18.6	16.9
Synthesis and Extraction	15.4	9.8
Pharmaceutical Dosage Formulation and Stability Testing	9.2	9.4
Toxicology and Safety Testing	9.7	7.0
Process Development for Manufacturing and Quality Control	9.0	7.3
Clinical Evaluation: Phase IV	3.7	4.0
Preparation, Submission and Processing of Applications	4.1	3.3
Bioavailability Studies	2.1	2.6
Other	8.4	13.0

Note: Figures pertain only to members of the Pharmaceutical Manufacturers Association. These 100-plus companies produce most of the ethical pharmaceuticals sold in the United States. Both the sales and the R&D figures cover ethical drugs alone.

Source: Pharmaceutical Manufacturers Association, *1989-1991 Annual Survey Report.*

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JEI

REPORT

A Two-Part Report: A and B

NO. 13B
April 3, 1992

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Yen Weakens In Face Of Economic Uncertainty

The one safe prediction concerning currency markets is that they will confound the experts. That statement was no truer than in late winter when the yen reversed course and began weakening. As a result of seven straight months of appreciating and after almost breaching the ¥120=$1.00 threshold, which would have established a new record high, the yen ended January at ¥125.8=$1.00. In February and March, however, the Japanese currency beat a retreat; as measured by its closing New York average the yen ended February at ¥129.5 and by March 31 was at ¥132.8 — close to its 1991 average value of ¥134.6 vis-a-vis the dollar.

The reversal of the yen's exchange rate reflects, in part, twists and turns in worldwide economic conditions. In the last months of 1991 Japan and other major industrial nations shared the misery of weak economies. Since policymakers in Tokyo and Washington took comparable monetary measures to spur their respective economies by cutting interest rates in late December (see *JEI Report* No. 1B, January 10, 1992), interest rates in Japan changed little relative to those in this country. As long as this remained true, international investors had little incentive to shift their preferred locations for investment. As a result, currency movements reflected factors other than interest rates.

But by February and March of this year the U.S. economy had entered the early stages of a weak recovery, arguably reflected in rising long-term interest rates. The Japanese economy continued to weaken, and the clamor increased for the Bank of Japan to lower the discount rate. Toward the end of March the central bank gave some indication that it might do so and actually took the plunge April 1, dropping the rate 0.75 percentage point to 3.75 percent, effective immediately. In this

Ministry of Labor has been urging firms to cut average annual working hours to 1,800 by the end of FY 1993 (March 31, 1994); this is a tall order given that the 1991 average of 2,022 hours was just 30 hours below that of the year before (see *JEI Report* No. 8B, February 28, 1992). Nikkeiren opposes this standard goal, arguing that individual firms have differing needs and should be allowed freedom to set work hours. Nikkeiren sees a level of 1,950 (comparable to the annual averages in the United States and Britain) as a reasonable target. In this year's wage talks settlements on nonwage issues announced to date include: a commitment by big integrated steel companies to add two or three extra days of paid holidays each year; agreement by Matsushita Electric Industrial Co., Ltd. to work toward the 1,800-hour goal by FY 1993 (the current average in the consumer electronics industry is 1,970 hours); and a pledge by automakers, which are most notorious for heavy overtime, to cut working hours from the current average of 2,200 to below 2,000 by the end of FY 1993.

Dissatisfaction by both labor and management with the *shunto* tradition intensified in 1992. Disparities in profits among industries and among firms within industries have become more acute. Lagging firms complained that a uniform wage settlement ignored their special situations. Labor unions have used similar arguments about flexibility to attack the spring tradition, arguing that companies that are doing well should offer higher wage hikes. A weakening or breakdown of the *shunto* tradition would have broad effects, including: widening the variation in labor costs among industries and among firms within an industry; expanding the variation in income growth among workers in different industries; renewing the importance of labor unions (economically and politically) as bargaining could become more substantive and less *pro forma;* and eroding the amicable labor-management relationship that has been considered one of the great strengths of the Japanese economy.

The wage negotiations are not yet complete, leaving open the possibility of Japan-style labor strife (symbolic strikes). The general outlines of this year's wage talks, however, are set. Not only will a modest increase in real wages sustain the growth of personal consumption and thereby keep the economy from sinking into a deep recession, but the sufficiently small hike works to allay BOJ fears about wage-push inflation.

Jon Choy

LDP, Miyazawa Boosted By Gunma Victories

Prime Minister Kiichi Miyazawa and the ruling Liberal Democratic Party bounced back after two successive defeats in by-elections earlier this year and seized both lower house seats contested in a March 29 special election in Gunma prefecture. This outcome surprised some pundits who had been skeptical about whether the ruling party could break its losing streak and Mr. Miyazawa, in turn, could hang onto the reins of government much longer.

The defeats of LDP-backed candidates in the February 9 by-election in Nara prefecture and the March 8 contest in Miyagi prefecture, both for upper house seats, were attributed widely to public disgruntlement with the ruling party's recurring involvement in money and bribery scandals (see *JEI Report* No. 10B, March 13, 1992). Various public opinion polls conducted prior to the Gunma contest, in fact, showed that Mr. Miyazawa's approval rating had plunged some 15 to 20 percentage points since December due to respondents' dual dissatisfaction with Japan's scandal-ridden politics and the prime minister's inability to affect Diet action on important domestic and foreign policy initiatives.

Confounding those analysts who had questioned whether the LDP could retain even the seat previously held by a ruling party delegate were voters who also awarded the second vacancy — previously held by a member of the Social Democratic Party of Japan— to an LDP candidate. While the prime minister is hardly home free, his party's success in the recent Gunma contest may buy him the time he needs to shepherd through the parliament a few key initiatives before voters throughout Japan go to the polls in July to select upper house representatives. High on Mr. Miyazawa's legislative priority list are proposals that would reform the Japanese political system and that would authorize Japanese participation in United Nations-sponsored peacekeeping operations.

Mr. Miyazawa said in a statement following the victories of Yoshio Yatsu and Yojiro Nakajima that he was "offering heartfelt thanks to voters for the LDP's victory." The prime minister added that as the year unfolds he plans to tackle such "key themes" as political reform, management of the economy, enhancing society's affluence and Japan's international contributions. LDP Vice President Shin Kanemaru, who was largely responsible for propelling Mr. Miyazawa to the premiership, concurred that the Gunma outcome was "very meaningful for the future of Japan."

The LDP doyen also hinted at one reason the LDP fared well in this election. The LDP "could score the victory not because the ruling party was good, but because the SDPJ was too bad," Mr. Kanemaru reportedly stated. In the Nara and Miyagi contests the opposition parties had sought to capitalize on the arrest on bribery charges of one of Mr. Miyazawa's close associates as well as reports that a number of LDP members had received money from Tokyo Sagawa Kyubin Co., Ltd., a company that allegedly has ties to organized crime. In recent weeks, however, it has become increasingly apparent that certain members of the political opposition also have received questionable political donations, particularly from Tokyo Sagawa. Thus, since none of the political parties appears to be above reproach, analysts suggest that the electorate evidently decided not to cast "anti-LDP, retaliatory votes" but instead back candidates from the party with the most governing experience. Concerns about Japan's flagging economy also may have compelled voters to stick with the LDP rather than endorse the candidate of a party with untested leadership experience.

The Gunma gains boost the LDP's membership in the 512-seat House of Representatives to 279; that number dwarfs the SDPJ's 137 members, Komeito's 46, the Japan Communist Party's 16, the Democratic Socialist Party's 13 and the United Social Democratic Party's 5 (see Table). Mr. Yatsu, who

Party Alignments in the Japanese Diet

(March 29, 1992)

House of Representatives	
Liberal Democratic Party	279
Social Democratic Party of Japan	137
Komeito	46
Japan Communist Party	16
Democratic Socialist Party	13
United Social Democratic Party	5
Rengo	0
Minor Parties	0
Independents	6
Vacancies	10
Total	512
House of Councillors	
Liberal Democratic Party	113
Social Democratic Party of Japan	71
Komeito	20
Japan Communist Party	14
Democratic Socialist Party	10
United Social Democratic Party	0
Rengo	13
Minor Parties	4
Independents	5
Vacancies	2
Total	252

previously served in the House of Representatives and decided to make another run for a lower house seat, garnered 106,600 votes, while Mr. Nakajima, a former reporter for Japan Broadcasting Corp. (NHK), received 89,066. Toshie Sunaga, the SDPJ-backed candidate, came in third with 66,432 votes. Keiji Kosuge, who ran on the Japan Communist Party ticket, brought up the rear with 6,854 ballots.

Barbara Wanner

Official's Visit Highlights Future Japan-South Africa Relations

The March 23-24 visit to Japan of South Africa's minister of foreign affairs provided a timely opportunity for discussions regarding the future of Japan's relations with that country. Roelof Frederick Botha's Tokyo meetings came the week after South African whites voted overwhelmingly in support of President F.W. de Klerk's efforts to reform Pretoria's racially discriminatory political system. Among several factors believed to have contributed to the success of the referendum were the threat of renewed economic sanctions and other international responses reflecting opposition to the policy of apartheid. Japanese business representatives were among those warning that bilateral economic relations would suffer if voters rejected Mr. de Klerk's reforms.

Japan had lifted most economic sanctions on South Africa last October (see *JEI Report* No. 41B, November 1, 1991) and in mid-January established immediate, full diplomatic relations with Pretoria (see *JEI Report* No. 3B, January 24, 1992). The Japanese government March 6 named former Consul General Masatoshi Ota as Japan's first ambassador to South Africa.

In talks with Mr. Botha Foreign Minister Michio Watanabe welcomed the results of the March 17 referendum. His South African counterpart reported that the Convention for a Democratic South Africa, a forum of 19 political parties participating in negotiations aimed at crafting a new constitution for the country, is expected to appoint an interim cabinet soon after an April meeting.

During his visit Mr. Botha also called on Japan to increase its support for the economic development of nations in Africa's southern tier, including South Africa (see Table). He cautioned that, without economic growth in his own country, unrest could undermine the process of political reform. Ministry of Foreign Affairs spokesman Masamichi Hanabusa noted in a March 24 press conference, however, that Tokyo would face "technical obstacles" in providing financial assistance to South Africa because of its relatively high per capita income. Citing earlier Japanese government efforts to invite trainees to Japan from South Africa's black communities, Mr. Hanabusa said Tokyo may consider bringing more trainees. "I think our cooperation will be primarily in the area of technical assistance," he added. Mr. Botha noted that Japan and South Africa intend to increase scientific and cultural exchanges. Japan suspended certain restrictions on personnel exchanges between the two countries last June (see *JEI Report* No. 24B, June 28, 1991).

Mr. Hanabusa also addressed an anticipated June visit to Japan by President de Klerk. Pointing out that the two countries have no particular bilateral issues that need to be settled, the Foreign Ministry spokesman described the visit as an opportunity to encourage the South African leader to "have the courage to continue" with his political reforms. Leaders of both countries also will be able, Mr. Hanabusa said, to discuss various means of promoting bilateral relations and cooperating to "contribute to a better standard of living in South Africa and in neighboring nations."

While in Japan Foreign Minister Botha assured business interests there that the de Klerk government is committed to maintaining a free market structure in South Africa. Alluding to international concerns that led Tokyo to place restrictions on its transactions with South Africa in the mid-1980s, he also asserted: "No one can turn around in the rest of the world and say to Japan you should not trade with an apartheid government. Those days are gone." Japanese government officials have indicated that they expect the success of the de Klerk referendum to have a positive impact on

Japan's Official Development Assistance to Southern Africa, 1986-90

(in millions of dollars)

Country	1986	1987	1988	1989	1990
Angola	$0.5	$1.4	$-2.0*	---	$0.0
Botswana	1.2	0.1	20.5	$11.3	0.7
Lesotho	0.6	2.2	1.2	0.6	0.8
Malawi	16.1	51.5	38.1	21.6	41.9
Mozambique	15.5	17.6	14.8	51.1	16.9
Namibia	---	---	---	---	0.2
Swaziland	0.5	0.2	0.04	0.02	0.1
Zambia	52.2	41.7	90.6	63.0	40.1
Zimbabwe	4.3	8.8	26.1	20.4	25.8

*Reflects repayment of loans.

Source: Ministry of Foreign Affairs

private-sector initiatives toward South Africa. Japan's business community remains somewhat cautious, however, worried about South Africa's political stability.

Various representatives of corporate Japan are continuing to prepare for improved business relations with South Africa and other nations in the region. Last April Keidanren (Japan Federation of Economic Organizations) dispatched a mission to South Africa to study social and economic conditions there (see *JEI Report* No. 19B, May 17, 1991). Between May 9 and May 23 the chairman of Keidanren's African Committee will lead another mission of representatives from Japanese manufacturing, trading and financial firms as well as officials from the Export-Import Bank of Japan, the Overseas Economic Cooperation Fund and the Ministries of Foreign Affairs and International Trade and Industry. A senior Keidanren official had warned prior to the March 17 referendum that the group "may have to suspend the [May] mission if the whites vote 'No' to President de Klerk's apartheid reforms and South Africa will face isolation again."

Soon after the nearly 69 percent vote in favor of reforms, Keidanren announced plans to proceed with the visit to South Africa as well as the Republics of Zambia, Zimbabwe and Botswana. The group's meetings with government and business leaders will be aimed at "deepening its understanding of the present political and economic situation, economic policy and investment climate in those countries," according to the Foreign Ministry's Mr. Hanabusa. The group also will discuss economic development in the region, Mr. Hanabusa said, "to explore the possibility of Japan's cooperation with those countries."

Keidanren's mission to South Africa last April reported that the country serves as a center for progress in the region, a conclusion that parallels Foreign Minister Botha's remark to Japanese officials that his country wants to act as the engine for the economic development of Southern Africa. Stability in South Africa itself naturally will effect the region's economic growth. The next few months may be critical to whether Japan's public and private sectors offer additional help to shore up Pretoria's restructuring efforts.

Margo Grimm

Notes

JAE Settlement - The case of the U.S. government against Japan Aviation Electronics Industry, Ltd. came to a close March 11 when the avionics manufacturer pleaded guilty to 10 counts of a 22-count indictment and agreed to pay $15 million in fines and penalties. Last September U.S.

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JAPAN · ECONOMIC · INSTITUTE

JEI

REPORT

A Two-Part Report: A and B

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JAPANESE, AMERICAN APPROACHES DIFFER ON AGING, LONG-TERM CARE

SUMMARY

The Aesop fable of the grasshopper and the ant seems particularly apropos for the American and the Japanese approaches to long-term health care, an issue that stimulates concerns among individuals as well as governments about future dependency needs and the demands of a fast-growing older population. A different outlook by Japanese and Americans toward aging strongly influences preparations for life in a society that has more senior citizens. This preparedness involves financial planning by governments as well as individuals. Americans, whose fears center on the cost of care, as a whole save less than the Japanese and increasingly have looked to government to help provide financial protection for long-term care. Older Japanese — who, because of steady savings and a national health insurance program, worry somewhat less about the cost of care — instead are concerned about whether the infrastructure for caregiving is adequate.

Beyond the issues of financial security and infrastructure are concerns about older citizens' health, since good health is another key determinant of whether long-term care will be required. The differences in the Japanese and the U.S. health insurance systems help explain not only why Tokyo has implemented reforms aimed at keeping Japan's elderly healthy and improving service to those who are not but why Washington continues to debate how best to cope with the patchwork quilt that has evolved for elderly Americans' long-term care coverage.

Avoiding Long-Term Care

Long-term care does not necessarily mean a nursing home, whether for reasons of poor health or perhaps temporary disability. Nor are dependent elderly the only clients; the disabled of all ages can need long-term, generally round-the-clock services. Such care can be provided, for example, in a home by family members or others. A combination of home and day-care services might serve other dependent populations. Lack of financial resources, too, can force dependency even when health considerations are not a major factor. Of concern to Japanese and American policymakers, however, is the prospect that a growing portion of their respective populations will be in the age group most associated with a need for long-term care, senior citizens.

By the year 2030 Americans of the postwar baby boom generation will form an estimated 22 percent of the population. Ten years before then the proportion of Japan's citizens 65 and older will make up 25 percent of that country's total population, according to estimates by the Ministry of Health and Welfare's Institute of Population Problems. The economic implications of such population shifts are broad, ranging from the prospect of fewer workers to support the social security demands of more retirees to the potential drain on the economy from government-supported health care programs covering the elderly.

Three interacting elements help improve the odds that an individual will not need long-term care: financial health, physical health and personal support systems. But each of these conditions involves a game of chance since not all individuals will require long-term care. Some will accept the risk that the roulette wheel will keep turning until the ball stops on someone else's number. If they bet wrong, their decisions will have serious personal as well as social consequences. This element of chance and the impoverishing costs that can accompany ill fortune have resulted in governments taking a key supporting role. Demographic and cultural changes in both Japan and the United States have elevated the expectations for government to provide a backup or be a substitute for the financial, physical and personal support systems that reduce the need for long-term care.

Staying Financially Healthy - Financial security in the "golden years" typically depends on earnings, to which social security and pensions are tied, plus savings and other assets. A worker not only has steady income but has a degree of health care security if his or her job provides health care benefits not otherwise affordable. Even more basic than these factors is that work tends to keep the body and the mind more active, which can stave off physical, if not mental, deterioration from lack of use. Thus, specialists in geriatrics like Robert Butler, the first director of the National Institute on Aging and now the American chair of the U.S.-Japan International Leadership Center on Longevity and Society at Mount Sinai Hospital in New York City, have urged that senior citizens remain in the paid work force to keep down their own and the country's health costs.[1]

- Through employment. From a regulatory standpoint, remaining in the work force is more of a problem for Japan's senior citizens than in the United States where the 1986 amendments to the Age Discrimination in Employment Act essentially eliminated mandatory retirement ages. In Japan a seniority-based employment system remains in place, if weakened somewhat by the tight labor market and evidence of more workers moving from job to job. Last year about 70 percent of the companies that employ 30 or more people said retirement was expected at age 60, or older, according to a Ministry of Labor survey. All but about 5 percent of the largest firms (those surveyed with more than 5,000 workers) have set 60 as the retirement determinant, with most of the remainder setting the time between 55 and 59, once the common retirement age in Japan. Government calls for the higher threshold of age 65 have met with resistance, although Japanese companies — many of them concerned about a labor crunch — have responded to government incentives to employ older workers by instituting a variety of programs, including rehiring retired workers or placing them in other jobs (see *JEI Report* No. 44B, November 17, 1989). In this way companies can limit the high cost of keeping senior workers on staff. As can be seen from Graph 1, men's earnings peak on average between age 45 and 55, depending on the size of the company. Women's earnings in smaller companies have little variation across the age spectrum, although the limited number of women working in large companies has experienced generally rising salaries. (The spike in the graph for women in large companies at ages 60-64 most likely results from the few women employed at that age — 20,220 in the Labor Ministry's June 1990 survey group — after an average time-on-the-job of 17 years. In contrast, the

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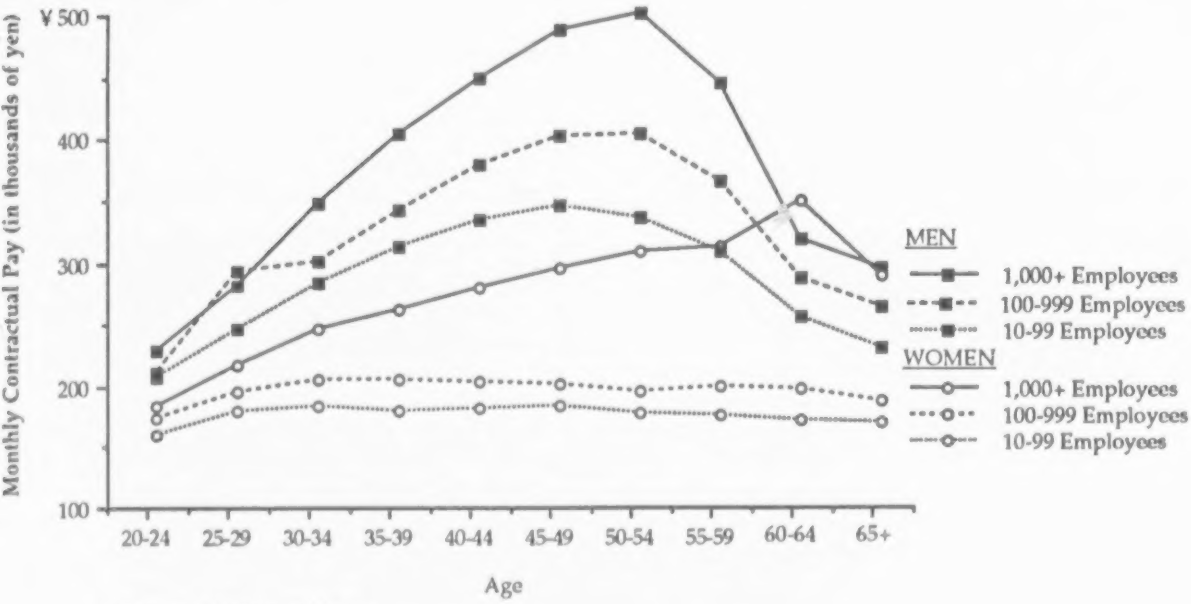
Graph 1: Average Monthly Earnings by Size of Company, Age and Gender in Japan, 1990



Source: Ministry of Labor

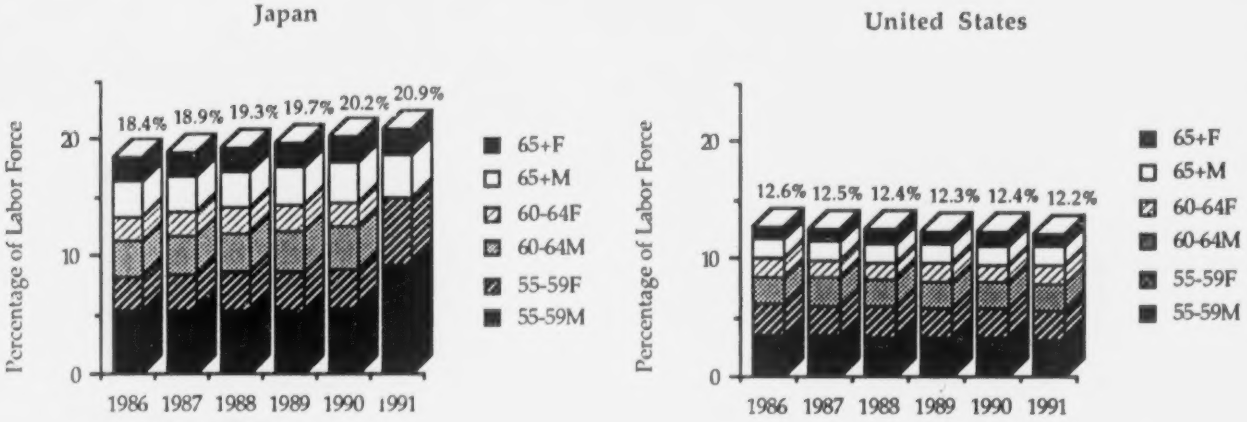
larger group of 60- to 64-year-old men, 40,870 in the survey, had worked for only 12.5 years in the largest firms polled, indicating that this group included a fairly high number of men who had moved into the company from other jobs.)

Despite the constraints regarding mandatory retirement in Japan and even though — or perhaps partly because — their earning power erodes as they age, more older Japanese workers stay in the labor force than do senior American workers. In 1991 employees aged 55 and older made up 20.9 percent of the Japanese work force, while the same age group amounted to 23.8 percent of the population. (Age 55 is used as a starting point for comparisons because some Japanese companies continue to require retirement at that age.) The growth rate of the working-age group in 1989 actually surpassed the growth in the population of the same age, a result that contrasts with the U.S. situation. The ratio of Americans over age 55 in the labor force declined slightly between 1986 and 1991 (see Graph 2), even though the corresponding proportion of the population grew by 0.6 percentage point over that period.

Year-to-year changes may not reveal a trend because other factors, like the state of the economy, may be critical. The drop in the ratio of older working people in the United States, for example, may not have resulted from voluntary retirement but may have stemmed from the slowdown in the economy and involuntary layoffs combined with difficulty in being rehired. Nevertheless, Table 1 indicates more senior employees in Japan's work force than in America's. The trend is the same for senior workers as a percentage of the 55-and-over population: about 44 percent of Japan's seniors are working compared with roughly 29 percent of their American counterparts. Government forecasters expect the U.S. number to increase in the future, since eligibility for Social Security benefits will shift from 65 for the average worker to 67 after the year 2000.

From the individual's perspective in both countries staying on the job means not only continued mental and physical activity but a steady income — if lower than its peak for older Japanese workers. Reasons for staying on the job past the normally expected retirement threshold vary and do not necessarily stem simply from concerns about meeting the cost of living in retirement.[2]

Graph 2: **Percentage of Japanese and U.S. Senior Labor Force by Gender and Age, 1986-91**



Note: For 1991 the category for 55-59 year olds also includes those for 60-64 year olds.

Table 1: **Japanese and American Senior Labor Force by Gender and Age, 1986-91**

(in millions)

	Japan					United States				
	Total Population	Work Force				Total Population	Work Force			
		Total	55-59	60-64	65+		Total	55-59	60-64	65+
1986	121.67	60.20	4.98	3.05	3.02	241.625	117.834	7.20	4.69	3.00
Male	59.81	36.26	3.16	1.85	1.87	117.820	65.422	4.19	2.76	1.80
Female	61.87	23.95	1.82	1.20	1.15	123.776	52.413	3.01	1.93	1.20
1987	122.26	60.84	5.14	3.22	3.12	243.942	119.865	7.20	4.67	3.10
Male	60.09	36.55	3.25	1.98	1.90	118.987	66.207	4.18	2.75	1.90
Female	62.17	24.29	1.89	1.24	1.22	124.928	53.658	3.02	1.92	1.20
1988	122.78	61.66	5.28	3.37	3.26	246.307	121.669	7.12	4.69	3.30
Male	60.35	36.93	3.34	2.09	1.97	120.189	66.927	4.10	2.73	2.00
Female	62.43	24.73	1.94	1.28	1.29	126.118	54.742	3.02	1.96	1.30
1989	123.26	62.72	5.41	3.56	3.39	248.762	123.869	7.09	4.79	3.40
Male	60.58	37.37	3.40	2.22	2.04	121.445	67.840	4.03	2.75	2.00
Female	62.67	25.33	2.01	1.34	1.35	127.317	56.030	3.06	2.04	1.40
1990	123.61	63.84	5.60	3.72	3.60	248.710	124.787	7.07	4.80	3.54
Male	60.69	37.91	3.48	2.34	2.17	121.239	68.234	4.01	2.80	2.03
Female	62.92	25.93	2.12	1.38	1.43	127.471	56.554	3.06	2.00	1.50
1991	124.14*	65.05	9.71		3.89	252.177*	125.303	7.04	4.71	3.50
Male	60.94*	38.54	6.04		2.37	---	68.411	3.97	2.72	2.00
Female	63.20*	26.51	3.67		1.52	---	56.893	3.07	1.98	1.50

*Estimated.

Source: For Japan Ministry of Labor (1986-90) and Management and Coordination Agency (1991). For the United States Department of Labor, Bureau of Labor Statistics, and Department of Commerce, Bureau of the Census.

In the past, however, Americans have viewed early retirement as a sign of the good life, a deserved opportunity to rest. From Washington's perspective such an attitude raises concerns about the degree to which citizens will rely on Social Security and government-funded programs instead of private financing for long-term care.

Younger Japanese, influenced in part by Tokyo's efforts to promote more leisure time by cutting working hours, may begin to show less fealty to the corporate work ethic at a time when government also is promoting increased years on the job. Both Tokyo and Washington would prefer that people continue working for more years; longevity increases mean that the sooner a worker retires the longer he or she will take money out of the social security system rather than paying into the trust funds. Were retirees just drawing on their own contributions this would not be a problem, but longevity and cost-of-living adjustments mean that most get a return far greater than they provided.

- Through social security and pensions. For most of those who retire in both countries social security and company pensions form the backbone of their income for future years. Of the nearly 21 million people 60-years-old and older in Japan in 1989, recipients of public pensions — similar to Social Security in the United States — numbered 19 million. Almost half of older households in Japan reported no other source of income than the public pension, according to the results of a 1989 MHW survey. Moreover, the basic public pension amounted to nearly one-half the reported income in the average older household. A 1989 tally of income sources for the average older Japanese resident calculated by MHW's Aged Persons' Health and Welfare Bureau indicated that 49.9 percent of the income came from public pensions, 34.4 percent from wages and salaries, 9.5 percent from interest earnings, 3 percent from public assistance other than pensions and 3.2 percent from other sources, including family support.[3] Growing numbers of Japanese reportedly are buying their own life insurance annuity policies. These are particularly popular among women; new subscriptions jumped by almost 40 percent in 1991. The rationale behind the policies lies in women's longer life expectancies and shorter enrollment period in public pensions.[4]

Of those Americans eligible for Social Security (including those who qualify as a result of disability or survivors of eligible workers), 39 million received benefits in 1990. Estimates provided to the 1991 Advisory Council on Social Security showed that nearly 62 percent of older U.S. families depended on Social Security for half of their income in 1988; that figure climbed to nearly 80 percent for those aged 85 and older. The advisory council's report showed that for an average senior citizen household 41 percent of the income flowed from Social Security, 17 percent from private pensions, 17 percent from wages, 24 percent from investments and 1 percent from other sources.[5]

With such large percentages of both populations relying on social security for a good portion of their postretirement income, survival of the systems would appear critical. In 1989 Tokyo called for reforms in its public pension system. Included were a provision for cost-of-living adjustments of benefits and a plan to gradually phase-in increases in contributions; employer and employee now split the contribution, which is 14.5 percent for men and 14.15 percent for women. For workers who are self-employed or for people contributing for an eligible nonworker, the flat-fee monthly contribution currently is ¥9,700 ($72 at ¥135=$1.00); that amount is expected to be raised again to keep the system solvent.

One problem developing from the rising pay-in rates in Japan is that roughly 25 percent of the self-employed or nonemployed aged 20 to 60 is not contributing, according to Japanese pension expert Kiyoshi Murakami. The requirement to enroll in the public pension program is mandatory, but no penalty has been described for those who refuse. Although about 2.2 million of the 17.2 million in this category have been exempted from paying fees because of limited income, as many as 2.3 million others simply are not paying. "It is inevitable that the higher the contribution, the more will drop out," Mr. Murakami has said. "Unless some measure is taken, the situation could become very serious within 10 years."[6] About one-third of the public pension program is supported by government subsidies, making compliance with payments for the remainder a major concern for policymakers.

Although Social Security is listed as the second-largest federal spending item after defense in this country, the program actually operates on a trust fund basis from employer/employee contributions, which this year are set at 6.2 percent each on the first $55,500 of salary. The excess monies accumulated in the old-age, survivors and disability insurance trust funds are used to buy government securities and, thus, function somewhat as a loan. In about 30 years payouts are expected to overtake contributions if no changes are made in present benefits or contribution levels. As described by a technical panel report submitted to the Advisory Council on Social Security, the Social Security program will need by the year 2020 or so "to use interest income and to redeem the [government] securities to meet OASDI costs (unless a tax rate increase or benefit change is enacted before then). These redemptions will represent a substantial demand on federal general revenues at that time."[7]

A clear difference exists between Tokyo and Washington regarding government's perceived role in assuring postretirement financial assistance. The Health and Welfare Ministry, the administrative body responsible for the public pension system that comes under the country's social security umbrella, has described the public pension as providing "income security that is sufficient as a major income source for retirement life."[8] At least until recently MHW viewed corporate pensions more or less as the icing on the cake. Beneficial tax treatment of corporate pension funds have worked, however, to encourage more companies to set up such funds (see *JEI Report* No. 21A, May 25, 1990).

Although many Americans have begun to expect Social Security to be their basic support after retirement (not necessarily one of the original aims of the program), Washington has promoted company-sponsored pensions through such laws as the 1974 Employee Retirement Income Security Act, which outlined a 10-year vesting requirement for private plans, and the 1986 Tax Reform Act, which stipulated minimum vesting rules and forbade companies from giving a disproportionate amount of retirement benefits to the best-paid employees. The recent Advisory Council on Social Security noted, however, that private pensions will continue to be secondary to Social Security as an income source for retirees. Projections put pensions at nearly 25 percent of the income received by all elderly in the year 2018, with Social Security still making up at least 39 percent.

Interestingly, Americans and Japanese now in the work force both are skeptical that the programs on which the current generation relies so heavily for postretirement support will be equally able to serve them in retirement. An October 1991 survey for the advisory council found that 51 percent of those questioned disagreed with a statement that Social Security would provide them benefits when they retire. Roughly 46 percent of those polled said their confidence in the system had eroded over the past five years, while 40 percent said their opinion had not changed in that time; 12 percent were more confident. In Japan a public opinion survey by the Central Council for Savings Promotion found in September 1989 that about 70 percent of those polled suspected that pensions and insurance would be insufficient after they retired. Another 35 percent-plus of the respondents suggested that their own retirement allowances would be inadequate. The Economic Planning Agency's *Annual Report on the National Life for Fiscal 1990* noted that rising concerns about financial stability during retirement "seems to help keep the savings rate high."[9] Since Japan's universal public pension system is only 30 years old, experience with the program may be insufficient to instill confidence among participants.

- Through savings. Economists increasingly are wondering whether the aging of Japan's population will result in dissaving by those who no longer earn as much and spend accumulated assets. Their interest often stems from the impact that Japan's high personal savings rate has had on the availability of capital for corporate Japan's investment activities. (For an economic analysis of Japan's aging labor force, see *JEI Report* No. 46A, December 7, 1990.) The question of dissaving also has implications for the financial security of older Japanese who might find themselves in need of long-term private care.

In the past analysts attributed Japan's high savings rate, in part, to an undeveloped pension system. Now, however, the pension system is more mature, although, as indicated, prospective recipients question whether the system will be adequate for their needs. Various studies and surveys have suggested that another reason for the continued high savings rate is that seniors want to leave a bequest to their heirs.[10] Whatever the reason, reports indicate that in the late 1980s older Japanese held on average savings of ¥17 million ($125,900). In addition, the current generation of senior citizens is likely to win more of the benefits of what remains of the 1980s home equity boom — if they choose to sell — than other generations. Eighty percent of older Japanese own homes (including about 70 percent in the Tokyo area).[11] This compares with a 61 percent home ownership rate in 1985 for all households in Japan.

Housing has been a key part of asset accumulation in the United States, where government financing programs as well as tax deductions for interest paid on mortgages have encouraged home ownership. Those Americans currently aged 65 and over who own homes are nearly as abundant among their contemporaries as are their Japanese counterparts among that nation's older population. Home ownership, however, remains a problematic asset in some respects since many elderly are land rich but poor in the liquid assets needed to pay for long-term care.

Americans appear optimistic about their ability to increase their savings rate from its current low of around 5 percent of disposable income (which compares with Japan's rate of 14 percent-plus), according to a survey conducted for the Advisory Council on Social Security. That October 1991 poll indicated that future retirees expect savings to form a larger part of their financial security than is the case for current retirees. Respondents under age 65 projected that earnings from investments would amount to 40 percent of their postretirement income. Although a report on financial resources for the elderly in the year 2018 also anticipated increased financial assets, the authors noted that almost 85 percent of financial assets will remain in the hands of those with the most wealth now. The majority of elderly (53.2 percent) is expected to be in the category with less than $10,000 in assets.[12]

Maintaining Physical Well-Being - Cultural attitudes as well as government policies toward health insurance play a role in maintaining a healthy citizenry. Good health, in turn, raises the threshold at which long-term care becomes more likely.

- Staying active. Japan's Health and Welfare Ministry has promoted an Active 80 Health Plan since fiscal 1988 to encourage improved habits for nutrition, exercise and nonwork-oriented recreation. Even before then the government encouraged community-based efforts to promote health awareness through use of "health passbooks" to record vaccinations, checkups and other pertinent information. For the elderly as well as mothers and young children community-funded health centers (numbering 848 as of March 1990) provide examinations. The government encourages routine checkups to start at age 40.

An emphasis on preventive care in Japan, plus coverage of more than 90 percent of the population under some type of health insurance program, could be expected to decrease the incidence of chronic health problems that can lead to needing long-term care. On the negative side, however, are concerns about overwork and *karoshi* (death from overwork). This phenomenon seems a likely cousin to high-blood pressure and stress-related problems that are linked to stroke, one of the leading causes of death in Japan. What is more important, the debilitation caused by stroke is one of the main factors blamed for Japan's high proportion of bedridden elderly — primary candidates for long-term care.

Inactivity by senior citizens also is a worry for those trying to decrease the necessity for long-term care in Japan. Mr. Butler, the former director of the National Institute on Aging, noted that cultural factors play a role in encouraging inactivity. In three-generation households, where a daughter-in-law might be at home with children and the mother-in-law, the younger woman is likely to be the manager of the home and may not expect any help from the older woman. "There's a curious malevolent side," too, the gerontologist said, citing a situation in which Japanese have not pushed for stroke victims to try to regain their faculties. "It is not expected that you would have to fight [to get better]. That's antithetical to good health."[13]

Other factors contributing to inactivity include the relative lack of hobbies by some Japanese who have spent their earlier years concentrated on a job. A September 1986 comparison by the Management and Coordination Agency of opinions held by the elderly in Japan, the United States, Denmark, Italy and Thailand found that, in general, Japanese respondents lagged in their active hobbies, except for gardening and traveling, as well as in their relations with neighbors and friends. The agency noted that Japanese hobbies averaged 3.3 for seniors, compared with 2.6 in Thailand and five or more in the United States, Italy and Denmark. Only group activities with other older people placed relatively high among Japanese, who ranked second in that category to U.S. seniors.

Whether American seniors on average are more or less active than their Japanese counterparts is open to debate. Less arguable is that Japan has a medical insurance system that encourages health maintenance more than do America's patched-together, less inclusive health insurance programs.

- Insuring preventive maintenance. Even before Japan's health insurance system for senior citizens kicks in for 70-year-olds (and bedridden 65-year-olds), Japanese retirees are covered under some form of insurance program. Those who formerly were covered by an employer-based health insurance fund can continue to pay premiums; coverage is subsidized by current workers' payments. Those ex-workers not covered by an employment-based insurance program can pay a set rate for National Health Insurance, which receives government subsidies for up to half the cost of benefits. Those who do not make payments are responsible for paying their full health bill in cash at the time of receiving services, but their payment will be reimbursed by the NHI fund since, in theory, they are covered by the national insurance program. (Those with low incomes receive help from welfare subsidies.) An estimated 17.7 percent of all households fall under a "households without income" category, which includes pensioners. They make up a growing segment of the people relying on the NHI program. (For details on Japan's health insurance program, see *JEI Reports* No. 16A, April 21, 1989, and No. 25A, July 5, 1991.)

Health insurance coverage is more of a problem in the United States, even though people age 65 and older (plus those who are disabled or suffering from end-stage renal failure) have access to Medicare. That program consists of hospitalization coverage, Part A, and voluntary coverage under Part B Supplemental Medical Insurance, which pays for physician services and a variety of outpatient services and supplies. Not only does Part B not pay in general for routine checkups and other forms of preventive care (except for mammography screening and pap smear tests), but not all Medicare participants choose to enroll in Part B. This leaves a small segment of the older U.S. population dependent on either private insurance, personal resources or Medicaid, a federal- and state-supported program for those whose incomes are low enough to qualify. An estimated 20 percent of the people enrolled in Medicare have no supplemental insurance but only their own resources to cover Medicare copayments and premiums plus other costs not covered by the program.[14]

Also a factor for policymakers weighing Medicare program costs is whether those who become eligible for Medicare will enter the program healthy. Since an estimated 35 million Americans are not covered by health insurance, there is a chance that some of these people will delay seeking medical attention, if possible, until they qualify for Medicare. Delays, of course, can worsen a medically needy person's situation and drive up the cost of care or increase the chance that a person will require long-term care.

Like Tokyo, which provides subsidies for the National Health Insurance plan, Seamen's Insurance program and government-managed health insurance funds for small companies, Washington has a direct interest in the rising costs of medical care through its 75 percent subsidy of Medicare Part B (see Appendix). Initially, the supplemental insurance portion of Medicare was expected to be less necessary than Medicare Part A, which was meant as an aid for meeting the high costs of hospitalization for members of the no-longer-working population who were having trouble obtaining health insurance. As a result, Medicare Part A operates on a trust fund basis and requires employer/employee payroll contributions of 1.45 percent each (on income up to $130,200) to fund benefits; Medicare Part B, however, originally involved a 50 percent government subsidy.

Although outlays for Medicare Part A still surpass those of the outpatient part of the program, costs for Part B are growing faster. Moreover, Part B premiums now fund only about 25 percent of program costs, with general tax revenues making up the difference. For this reason Washington has a keen stake in controlling costs for Medicare Part B; it took steps in that direction this year with a plan to readjust payments to physicians. For Part A, which is expected to deplete its trust fund resources at current contribution rates as early as the year 2006, political considerations also are a spur to controlling medical care costs. Since very few of Medicare's resources go to long-term care, the link between the two rests primarily on Medicare's ability to help senior citizens avoid the debilitating conditions that can lead to a need for long-term help.

Relying on Personal Support Systems - One of the major cultural differences between Japanese and Americans is the concept of group-oriented behavior in contrast to independence. This attitude carries over to living arrangements. In Japan a three-generation household is common; such a household in modern America is unusual (see Tables 2 and 3). The traditional Japanese pattern, though, appears to be altering in the face of economic and demographic forces.

The move of young Japanese workers to cities in search of higher-paying jobs and the increasing wealth that has enabled more families to set up nuclear households are two factors that have led to a decreasing percentage of older Japanese living with adult children. Those over 65 who are living with children represent about 60 percent of older Japanese households whereas just 10 years ago that ratio was 70 percent, itself a drop of 10 percentage points from 30 years ago. In the United States the percentage of 65-year-olds whose children or other relatives live with them is closer to 11

Table 2: **Estimated Number of Elderly Japanese Households by Type**, 1980-89

(in thousands of people)

	1980	1985	1986	1987	1988	1989
Total Households, 60+	15,270	17,429	18,400	19,079	19,727	20,873
Living Alone	1,261	1,521	1,711	1,749	1,888	2,125
Living As Couple	3,299	4,490	4,588	5,008	5,331	5,854
Living With Children	10,187	10,780	11,319	11,551	11,636	12,032
With Married Children	7,126	7,349	7,530	7,781	7,564	7,627
With Unmarried Children	3,061	3,431	3,789	3,770	4,072	4,405
Other*	523	638	782	770	873	862
Total Households, 65+	10,729	12,111	12,626	13,030	13,491	14,239
Living Alone	910	1,131	1,281	1,290	1,405	1,592
Living As Couple	2,100	2,791	2,784	3,039	3,259	3,634
Living With Children	7,398	7,820	8,116	8,252	8,345	8,539
With Married Children	5,628	5,800	5,897	6,043	5,971	6,016
With Unmarried Children	1,770	2,019	2,219	2,209	2,373	2,524
Other*	321	369	446	448	481	474

*Includes households with relatives other than children or households of unrelated persons.

Source: Ministry of Health and Welfare, *Health and Welfare Statistics in Japan.*

Table 3: **Estimated U.S. Households Headed by Those Aged 65 and Older by Living Status, 1986-89**

(in thousands of households)

	1985	1986	1987	1988	1989
Total Households, 65+	18,100	18,596	18,998	19,455	19,714
Alone	8,112	8,318	8,511	8,683	8,851
As Couple	n.a.	8,289	8,457	8,631	8,731
Other*	n.a.	1,989	2,030	2,141	2,132

*Includes households with nonspouse relatives, including children, or households with unrelated persons.

Source: Department of Commerce, Bureau of the Census, *Statistical Abstract of the United States.*

percent (with those who live in a child's home adding an estimated 9 percent). Migrations by adult children in search of jobs as well as retired parents in search of homes in sunny states like Florida and Arizona have contributed to the low number of three-generation American households.

Despite the complaint in the 1980s that adult children were returning to the nest because of the high cost of independent living, older Americans generally do not expect their children to provide the home-centered care that might be necessary to avoid entering a nursing home. Many Japanese senior citizens, however, continue to expect immediate family or relatives to care for them as they become more dependent in old age. As many as 81 percent of the respondents to a 1987 survey by the Management and Coordination Agency voiced such an expectation. Americans are not oblivious to family help, however. The previously noted 1986 survey by the Management and Coordination Agency on opinions from older people in five countries asked a similar question. The majority of Americans (69 percent) said family and relatives would look after them if their health failed. Since multiple responses were possible, the second-most listed option was private-paid services (40.5 percent). That answer drew only a 4.9 percent response in Japan compared to the 95 percent expectation for family support.[15]

When Long-Term Care Becomes Necessary

America's 20-year-plus experience with developing nursing homes and other alternatives for long-term care has both advantages and disadvantages, in ways that are a mirror image for Japan, at least in some cases. Where a variety of long-term care facilities has sprung up in America (see Table 4), the options until a few years ago were more limited in Japan (see Table 5). Americans, however, have not developed a coordinated policy toward long-term care and its funding, and the consequent helter-skelter growth of the long-term care system now complicates policymaking. One view of the development of the U.S. nursing home industry, in fact, said:

> The case of public policies pertaining to nursing homes in the United States is perhaps the most stark example of policy provisions permitting the creation of an entire industry. This happened as service providers were able to broker open-ended public appropriations with a broad-based need for institutional care in the absence of other care alternatives.[16]

Japan has had somewhat more leeway to adopt comprehensive policies, although it would be misleading to describe the situation as a "newcomer" phenomenon. Some of the new policies are being developed to meet changing demographics. Others have arisen in response to previous misjudgments.

Table 4: **Long-Term Care Facilities in the United States, 1986***

	Number	Beds (thousands)	Occupancy Rate
Skilled Nursing Facilities	6,897	n.a.	n.a.
Nursing Homes**	16,388	1,507.4	91.7%
Government-Run	789	99.7	93.6
Proprietary	12,336	1,079.0	91.3
Nonprofit	3,263	328.7	92.4
Residential Facilities***	9,258	201.8	85.4
Government-Run	256	6.8	85.3
Proprietary	7,887	156.5	85.1
Nonprofit	1,115	38.5	86.5

*Excludes hospital-linked nursing homes.
**Defined as those at which a person needs some form of nursing care.
***Defined as those homes where no care is required.

Source: Department of Commerce, Bureau of the Census, *Statistical Abstract of the United States.*

The U.S. Situation — A surprise for many Americans facing the prospect of entering a nursing home is that in almost all cases they will be expected to pay the full cost unless they have an insurance policy that specifically covers long-term care or have so few assets that they meet their state's eligibility guidelines for Medicaid. Some elderly "spend down" or shift their assets in advance to family members as a way of becoming eligible for Medicaid. Others are impoverished by the costs of care and become eligible in that way. Less than 5 percent of the older population currently has long-term care insurance policies, which until recently were rare and which still generally are expensive. Although Medicare's Part A hospitalization insurance covers some nursing home care, eligibility is limited primarily to acute cases in which rehabilitation is expected. In other words, private resources are necessary for roughly 45 percent of the estimated 43 percent of the U.S. population aged 65 and over that at some time will need institutionalization as a result of chronic illnesses or situations in which they no longer have the financial, physical and personal support to stay at home. What may be more of a shock for the typically insured Americans eyeing these costs is that their prior experience with nonnursing home health care expenses required out-of-pocket expenses for only about 27 to 38 percent of costs.[17]

Also a potential shock is the cost of institutional care in the United States, which can approach $31,000 to $36,000 a year. This amount is far higher than the median annual income of 65-year-olds receiving Social Security benefits — estimated at $7,950 — and more than twice as much as the estimated median income from all sources of $11,750, as presented in the Advisory Council on Social Security's review of the elderly population's financial resources.

Moreover, the use of nursing homes is rising, according to Department of Health and Human Services researchers, who reported last year that three times as many people entered nursing homes in 1985 than did in 1965. A March 1992 report by the advocacy group Families USA showed that out-of-pocket expenditures for nursing home care quadrupled in the past 30 years, while projections drawn up last year for the Health Care Financing Administration put nursing home expenditures for the year 2000 at $131 billion, almost three times the $54.5 billion spent in 1990.

Efforts to promote alternatives to institutionalization, such as home health care, have led to growing public expenditures in those areas, although the outlays may have offset part of the costs of institutionalization. An analysis of 1990 national health expenditures reported, "Spending for home health care grew faster than spending for any other category of personal health care in 1989 and in 1990 ... primarily because of increased funding by the Medicare and Medicaid programs." Increases in Medicare's home health expenditures rose 24.9 percent, while Medicaid's home health costs climbed 22.5 percent. The outlay by both programs totaled $8.5 billion in 1990.[18]

These escalating home health costs plus federal and state governments' rising outlays for Medicaid — the main public program addressing nursing home costs — have stirred policymakers to ponder how to both reduce expenditures and spread the risks. Results, however, have been limited. Suggestions that push more responsibility onto the government and encourage funding outside the welfare-associated Medicaid program have collided with federal budget deficit constraints and the fear that so-called entitlement programs are soaking up too much of government spending. Calls to incorporate more cost-sharing in such public programs as Medicare have run into resistance from not only the public but policymakers wounded by the passage then revocation of the Medicare Catastrophic Coverage Act of 1988, a measure that tried to reallocate the funding responsibility for

Table 5: **Type and Number of Japanese Residential and Nursing Facilities for Seniors***

Special Nursing Home	Serves 65-year-olds and older whose physical needs make care difficult at home. About 2,125 homes with 152,988 beds as of late 1989.
Ordinary Nursing Home	Serves those aged 65 and older whose physical, financial or home situation make living at home difficult. Clients' families either must be entitled to public assistance or exempt from local government taxes due to income levels. About 950 homes with 68,118 beds.
Homes Allowed to Set Moderate Fees	Serves those aged 60 or older with low incomes who have difficulties living at home because of circumstances, not necessarily health-related (for example, those with no relatives able to provide home care). Type A homes, of which there are 251 facilities and 15,161 beds, serve meals, while Type B homes, of which there are 39 facilities with room for 1,880 people, expect residents to provide their own meals.
Short-Stay Facility	Similar to a skilled nursing facility in the United States since the 65-year-old and older clientele are admitted because of acute illness or short-term problems and are expected to be able to return to their home. The first of four facilities opened in 1989; up to 200 people can be served.
Fee-Charging Nursing Homes	Serves those aged 60 and older who generally are in good health. They are provided meals and daily necessities. About 155 facilities that can accommodate 15,742 people.
Residential Communities	Apartment-style residences specially equipped with structures and features, such as emergency notification systems. Plans called for building five facilities in FY 1987 and up to 21 more by FY 1990.
Privately Owned Senior Housing Units	An estimated 173 facilities that can serve about 13,500 residents have been built throughout Japan.

*Excludes geriatric facilities that essentially are hospitals but with fewer medical personnel than at regular hospitals. Also omits hospitals that may serve a high number of long-term senior patients but are not considered geriatric facilities.

Source: Ministry of Health and Welfare and *Look Japan*, March 1992.

catastrophic care coverage by increasing Medicare Part B premiums to put more of a burden on current Medicare enrollees rather than shifting the cost to all current and future generations through general tax revenues.

The Situation in Japan — Concerns about the rapid aging of the population prompted government studies in the early 1980s to develop programs that would keep older people healthy for as long as possible but also provide services for those in need. Looming as a large problem for both the central and the local governments was their combined 30 percent subsidization of the costs covered by the Health Insurance for the Aged program. (Employment-based insurance funds provide the remaining 70 percent of funding.) This was a particular concern because of a tendency to allow bedridden elderly to use hospitals for long-term care.

From the government's perspective one of the worst options was to encourage prolonged hospital use by people with long-term care requirements but little need for extensive medical treatment. Services in hospitals generally are greater than in nursing homes, but so are costs. Moreover, the Diet's 1991 increase in copayments required of senior citizens for hospitalization showed the token nature of the fee; the ¥600 ($4.40) a day to be charged starting in 1992 fell 96.8 percent short of meeting actual inpatient treatment costs (see *JEI Report* No. 38B, October 11, 1991).

Another reason the Japanese government prefers older people to receive nonacute, long-term care in nursing homes or at home rather than in hospitals is that even if local governments provide public assistance to some elderly entering nursing homes at least they can take into account the person's assets in determining the degree of support. For example, in a special nursing home (those in which a person's physical requirements are such that regardless of financial circumstances institutional care is deemed most appropriate) the government covers the full cost if an entrant's annual income is less than ¥270,000 ($2,000). A sliding scale then determines contributions from the residents. The upper limit for monthly payments for any patient at a special nursing home is ¥180,000 ($1,333). Moreover, since Japanese civil law requires children to decide which sibling is responsible for supporting their parent(s), local governments can ask the children of residents in special nursing homes to contribute to their parent's care. Although the situation varies among communities and prefectures, an adult child considered responsible for parental nursing home care could be asked to pay the entire monthly bill if his or her national income tax payment for the year tops ¥6,270,000 ($46,400). A sliding scale determines assistance levels up to that amount, starting at payments of ¥9,000 ($67 a month) if a supporting child's annual income tax payment is ¥30,000 ($222) or less. Smaller amounts are possible for those exempt from paying local income taxes.[19] (In the United States similar support laws had been phased out by the 1960s, according to M. Powell Lawton, an expert on caregiving for the elderly at the Philadelphia Geriatric Center. He noted, however, that there have been some rumblings of new efforts to revive such legislation.[20])

The Japanese government sweetens the burden of caregiver support in various ways, ranging from income tax deductions to efforts to provide more home helpers under a Gold Plan aimed at preparing Japan by the year 2000 for an older society. Among the deductions possible are ¥450,000 ($3,300) on national income taxes and ¥290,000 ($2,148) on local income taxes for those who support a relative aged 70 or older. If the support is for a parent or grandparent living with the relative, a deduction of ¥100,000 ($741) is allowed at the national level and ¥40,000 ($296) at the local level. Support of bedridden or senile relatives merits a federal tax deduction of ¥300,000 ($2,200) and a local tax deduction of ¥80,000 ($593).

The Gold Plan, a major policy initiative expected to cost about $40 billion over the next 10 years, represents a comprehensive approach to addressing the needs of an older population (see Table 6). Primary among the objectives are efforts to decrease the number of bedridden Japanese, estimated at 4.2 percent of the home-based population in 1984 and 1.4 percent of the population that had been hospitalized for more than six months.[21] Among the measures are an increased number of rehabilitation centers and vehicles with lifts capable of handling wheelchair-bound patients. Other

Table 6: **Proposals for Japan's 10-Year Plan Promoting Health and Welfare of the Elderly***

Program	FY 1989	FY 1990	FY 1991
Promotion of Home-Centered Care			
▪ Increase Number of Home Helpers	31,405 people	+4,500 people	+5,000 people
▪ Increase Number of Beds in Short-Stay Special Nursing Homes	4,274	+3,400	+4,000
▪ Increase Number of Day-Care Centers for Elderly	1,800	+700	+850
▪ Increase Number of Organizations That Support Home-Centered Care	--	300	+400
▪ Increase Number of Towns and Cities with Information Centers Aimed at Improving Seniors' Lifestyles	30 sites	50 sites	+50 sites
Promotion of Rehabilitation Programs to Limit Number of Bedridden Elderly			
▪ Insure Places for Rehabilitation	3,849 sites	+467 sites	+467 sites
▪ Provide Transportation for Disabled, including Microbuses with Lifts	--	1,054 buses	1,287 buses
▪ Expand Stroke Information System	--	10 prefectures	+5 prefectures
▪ Fund Information System to Help Prevent Strokes, Broken Bones	¥17.63 billion	¥17.78 billion	¥18.03 billion
Funding to Help Complete Home-Centered Welfare System for Seniors	¥10.0 billion	¥60 billion	–
Expand Number of Nursing Home Beds			
▪ Add to Beds in Specialized Nursing Homes	8,000 beds	10,000 beds	10,000 beds
▪ Add to Facility Sites Serving General Welfare Homes for Elderly	150 sites	250 sites	275 sites
▪ Increase Number of People Who Can Be Served at Brief-Stay Care Facilities	200 people	1,500 people	3,000 people
▪ Establish Centers to Promote Improved Lifestyles for Senior Citizens	--	40 centers	40 centers
Promote Local Government Support for Organizations that Enhance Lifestyle of Senior Citizens			
▪ Increase Number of Prefectures Served	15 prefectures	30 prefectures	47 prefectures
▪ Increase Number of Model Projects	152 sites	304 sites	304 sites
Fund Scientific Research on Elderly	¥508 million	¥1.0 billion	¥1.39 billion
Complete Integrated Welfare System Embodied in "Hometown 21" Project	¥60 million	¥60 million	¥60 million
Insure Staffing for Gold Plan			
▪ Set Up Information Centers for Welfare Specialists	--	--	15 sites
▪ Establish Personnel Bank for Welfare Specialists	--	--	95 sites
▪ Fund Enterprises That Promote Home-Centered Welfare Services	--	--	¥1.0 billion

*Initial budgets.

Source: Koseisho Daijin Kanbo Rojin Hoken Fukushibu, *Rojin no Hoken Iryo to Fukushi, Seido no gaiyo to doko*, p. 41.

major objectives as the central government seeks to drive down institutionalization costs are more support for community-based case-management and education programs for the elderly, plus triple the number of home helpers (provided at a charge of around ¥650 or $4.70 an hour or less, depending on a family's financial situation, according to 1990 figures calculated by the Economic Planning Agency).

Expansion of the number of beds and types of nursing homes also falls within the parameters of the Gold Plan. Nobuo Maeda of Sapporo Medical College in Hokkaido has suggested that government restrictions on the building of nursing homes prior to 1985 — out of concern that more homes would increase the costs for which government might be responsible — had resulted in longer hospital stays by elderly in need of long-term care. A lack of nursing home beds, he said, also drove up the wait for openings in existing homes, a wait that at a minimum was around six months.[22]

Although profit-oriented nursing homes were rare in Japan until the late 1980s, according to Mr. Maeda, the government has begun to support efforts by private enterprise to build communities incorporating nursing homes. One of the leading proponents of such projects is a consortium in which America's largest nursing home operator, Beverly Enterprises, Inc., has a 42 percent stake and Shimizu Corp., a major Japanese contractor, has a 43 percent interest. Bobby Stephens, vice president of development for the Fort Shaw, Arkansas-based firm, says the joint venture has nine projects under construction and four in operation. The communities usually include condominium units as well as a nursing home and a clinic, plus recreational facilities.[23]

The upscale new retirement communities with their attached nursing homes stand in contrast to the nursing homes more typical of Japan's past, in which most patients were bedridden and received primarily personal, rather than medical, care. Expectations that a wealthier generation will move into the $375,000 condominiums in such retirement communities as those run by Beverly Enterprises has raised concerns among some directors of older nursing homes. They fear that their facilities will be unable to compete[24] or that greater class distinctions will result in the older homes being associated with a welfare clientele.

Nevertheless, senior citizens surveyed by the Housing Loan Corp. in 1990 about how much they would be willing to spend to live in a comprehensive care type of retirement community showed that 26.7 percent were interested in memberships at the $300,000 and above level.[25] The degree of interest in retirement/nursing home communities also is attracting Japanese insurance companies. A representative of Nippon Dantai Life Insurance Co. has been quoted as saying, "The Japanese government is encouraging us in this area because it hopes to use the private sector to supplement the weak welfare system."[26]

Other worries about infrastructure deal with the unavailability of facilities on a uniform basis throughout Japan. As a result, Tokyo has funded prefecture-targeted pilot projects to improve the range of care options. Similar projects are under development in the United States, which also has concentrations of elderly in some states and scarce resources in others. (Private nursing home operations, which provide the majority of long-term beds in the United States, are wary of opening homes in some states, however, because reimbursement rules on Medicaid vary from state to state and the home may not be able to limit services to only private-pay residents.)

Moves to develop infrastructure in Japan for various long-term care options have come at a time when women are returning to the labor force in increasing numbers. This creates additional family wealth but also leaves homebound elderly relatives in need of alternate support systems, including day-care centers, respite facilities and home helpers. The rush to create infrastructure plus the labor shortage that could restrict the number of home helpers available for community-based support systems could combine in an unfortunate turn of events to push Japan toward an increased emphasis on institutionalization. Rehabilitation efforts then might fall short, since the goal of returning the elderly to their homes usually depends on the availability, at least temporarily, of a nearby caregiver.

Impact of Aging and Long-Term Care Approaches

The results of Tokyo's 1980s-era policies and the patchwork quilt of policies developed in Washington over the past 25 years or so have implications not only for the respective populations as a whole but for companies in both countries competing in world markets. The current generation of Japanese seniors who grew up in the harsh economic times of the war years and participated in bringing Japan to economic superpower status may be able to appreciate the government's efforts to improve social security, pensions and — for those who want to continue working past 55 or 60 years of age — delayed retirement ages. Emphasis on improved living conditions and relatively low-cost health care for older people also work to their benefit.

Younger workers in Japan, however, might find that certain changes have contradictory messages. For example, in line with international calls for Japan to conform to the working-hour standards evident in other major industrial countries plus Tokyo's stated intention of increasing society's ability to enjoy the fruits of its labors, government has a policy of reducing the number of hours worked a year to 1,800 by the end of Fiscal 1993. This is expected to increase Japanese workers' leisure pursuits; that, in turn, would decrease their stress-filled work lives and lead to healthier workers. However, the effect could lead to more people willingly choosing early retirement — countering government's efforts to boost the normal retirement age to 65. Of course, longer working lives might be no hardship if work and play are in better balance.

In the United States fewer older workers are in the work force and that raises concerns in Washington about demands on Social Security and Medicare. Since current retirees are expected to live well into their 80s, some could receive benefits to some extent for more than 20 years from government-administered trust fund systems (plus government subsidies in the case of Medicare). Among options mentioned for revising Social Security and Medicare is to boost the ages of eligibility for both programs, but such moves would put more strain on employer-funded pension and health-care systems; thus, these changes are not seen as likely in the immediate future. Mr. Butler of the International Leadership Center on Longevity and Society has noted, "Baby boomers are where the answer lies. They are beginning to see that society will be very ill-prepared for them." The group is so large, he said, "that elected officials will have to respond to them." He added that when people begin to realize that they may live until age 100 or more, they may see a greater necessity for continuing work for as long as they are able.[27] This prospect has both good and bad elements as far as companies in both countries are concerned.

Implications for Japanese Companies - Even though corporate Japan remains interested in retaining its seniority-based employment system, which encourages older employees to retire and make way for younger workers whose salaries are correspondingly lower, a longer work life for the average employee would offer some advantages to a company. The longer that workers are employed, for example, the more they will contribute to health insurance and company pension plans. Given that active people have better prospects of avoiding chronic debilitation than those who are sedentary, workers also can be expected to make fewer demands on the health care system. Moreover, less financial strain on the health insurance and public pension funds — to which Japanese employers and workers contribute — could lower the likelihood that premiums would have to be raised. Another expected benefit of longer employment would be continued high savings by older workers; these savings, in turn, could continue to help fund Japan's corporate plant and equipment investment.

Tokyo's moves to emphasize home-centered care of senior citizens and encourage more private resources for nursing homes also relieves the strain imposed on company-affiliated health insurance funds, which together contribute 70 percent of the financial support for the Health Insurance for the Aged program. Even though the government has upped contributions required of employer-linked insurance funds to the Health Insurance for the Aged program, the contribution is made annually on a lump sum basis and severs companies' ongoing liability for "graduates" from the employee-based system. Since companies also pay national and local corporate taxes, any efforts to decrease government subsidies for the National Health Insurance, Health Insurance for the Aged and public assistance programs probably would meet with corporate appreciation. In addition to the positive tax and benefit effects generated under Tokyo's policies on aging and long-term care, some companies gain expanded opportunities to serve an increasingly affluent elderly population.

Implications for U.S. Companies - Lack of a coordinated U.S. policy toward aging and long-term care issues complicates planning by companies concerned about whether Washington will act to boost Social Security and Medicare taxes or move to require more involvement by companies through extension of the eligibility age (and, thus, extended payroll tax contributions) for Social Security or Medicare. These are concerns for almost all companies, regardless of size. Companies that pay into health or retirement funds for their employees, however, also find their planning hampered by government's lack of a clear signal on whether it intends to favor more public support or more private-based and individual responsibility for postretirement financial and health insurance systems. Complicating the situation is a question of legal liability for continued pension and health insurance coverage for firms that have declared bankruptcy.

Another concern is that if government does not act to control costs or readjust these programs, resources will be diverted to entitlement programs and cause havoc with the federal budget; that is a theme some officials on Capitol Hill are trying to push as an election-year topic. The mix of public and private support that has developed to date to serve an older populace also has raised questions of intergenerational equity. Critics contend that retirees have improved their status through their voting clout, while more young Americans are seen as at risk. Policy decisions to date have encouraged private enterprise to enter the for-profit nursing home business and offer expanded insurance offerings, but other policies have led a majority of Americans to expect increased public support for both the anticipated and unforeseen costs awaiting a generation of retirees.

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Dan Levison provided research assistance.

NOTES

[1] Telephone interview with Robert Butler, U.S. director of the International Leadership Center on Longevity and Society, Mount Sinai Medical Center, New York, New York, March 31, 1992.

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[3] Ministry of Health and Welfare, Aged Persons' Health and Welfare Bureau, *Rojin no Hoken Iryo to Fukushi* (Tokyo: Zaidan Hojin Choju Shakai Kaihatsu, 1991), p. 14.

[4] Akiko Kusaoi, "¥1,605,337,700,000," *Look Japan,* March 1992, p. 46.

[5] Advisory Council on Social Security, *Future Financial Resources of the Elderly: A View of Pensions, Savings, Social Security, and Earnings in the 21st Century* (Washington, D.C.: 1991), p. 12.

[6] Kiyoshi Murakami, "Pension Programs in Japan," *International Pension Lawyer,* No. 8, May 1991, p. 16, and personal correspondence, April 7, 1992.

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[8] Ministry of Health and Welfare, *Annual Report on Health and Welfare 1990-1991* (Tokyo: Japan International Corporation of Welfare Services, 1992), p. 126.

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[13] Butler, *op. cit.*

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[15] Management and Coordination Agency, *"The Summary of International Comparative Survey on the Life and Opinions of the Elderly"* (Tokyo: Foreign Press Center, 1986), and Economic Planning Agency, *op. cit.*

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[19] Ministry of Health and Welfare, Aged Persons' Health and Welfare Bureau, *op. cit.*, pp. 124-125.

[20] Telephone interview with M. Powell Lawton, Philadelphia Geriatric Center, Philadelphia, Pennsylvania, April 6, 1992.

[21] Nobuo Maeda, "Long-Term Care for the Elderly in Japan" in Teresa Schwab (ed.), *Caring for an Aging World* (New York, New York: McGraw-Hill, 1989), p. 249.

[22] *Ibid.*

[23] Telephone interview with Bobby Stephens, vice president of development, Beverly Enterprises, Inc., Fort Shaw, Arkansas, March 30, 1992.

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[25] Economic Planning Agency, *op. cit.*, p. 69.

[26] Kusaoi, *op. cit.*

[27] Butler, *op. cit.*

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

APPENDIX

Japan's National Medical Expenditures and Portion Paid for Seniors' Care, 1985-90

(in millions of yen except for per capita amounts)

	1985	1986	1987	1988	1989	1990
National Medical Expenditures	¥16,015.9	¥17,069.0	¥18,075.9	¥18,755.4	¥19,710.0	¥20,900.0
Growth Rate	6.1%	6.6%	5.9%	3.8%	4.9%	6.0%
As Share of National Income	6.3%	6.5%	6.6%	6.4%	6.4%	6.4%
Outlays for Seniors' Care (70+)	¥4,067.3	¥4,437.7	¥4,830.9	¥5,159.3	¥5,550.0	¥6,000.0
Per Capita for Seniors	499,000	523,000	549,000	568,000	593,000	618,000
As Share of NME	25.4%	26.0%	26.7%	27.5%	28.2%	28.7%
As Share of National Income	1.6%	1.7%	1.8%	1.8%	1.8%	1.8%

Source: Ministry of Health and Welfare, Bureau for Aging Insurance and Welfare Assistance, *Rojin no Hoken Iryo to Fukushi* (1991), p. 63.

U.S. National Health Expenditures and Portion Paid for Selected Seniors' Programs, 1985-90

(in millions of dollars except for per capita amounts)

	1985	1986	1987	1988	1989	1990
National Health Expenditures	$422,600	$454,800	$494,100	$546,000	$602,800	$666,200
Per Capita	1,710	1,822	1,961	2,146	2,346	2,566
Growth Rate	11.1%	7.6%	8.6%	10.5	10.4%	10.5%
As Share of GNP	10.5%	10.7%	10.9%	11.2%	11.6%	12.2%
Personal Health Care Expenditures*						
Nursing Home Care**	$34,100	$36,700	$39,700	$42,800	$47,700	$53,100
Home Health Care**	3,800	4,000	4,100	4,500	5,600	6,900

*Excludes from national health expenditures the costs for program administration and the net cost of private health insurance plus government public health activities, research and construction.
**In 1989 Medicaid paid $20.6 billion toward the cost of nursing home care, while Medicare covered $3.6 billion. The comparable numbers for home health care were $1.9 billion and $2.1 billion, respectively.

Source: Health Care Financing Administration, *Health Care Financing Review*, Fall 1991.

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REPORT

A Two-Part Report: A and B

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JAPANESE CORPORATE MANAGEMENT: DOES IT NEED TO BE CHANGED?

SUMMARY

Regarded by many business leaders in Japan as fundamental to the efficiency and worldwide competitiveness of Japanese industry is the Japanese way of management. Several factors characterize this management form, including: a higher ratio of retained earnings, which allows Japanese companies to invest more of their own resources in plant and equipment and/or research and development; long-term relationships between employers and employees as well as between large manufacturers and small- and midsized suppliers; plus consultation between the government and the business sector.

Recently, however, Japanese management practices have encountered serious criticism both at home and abroad. Japanese workers are becoming more concerned about enjoying their personal lives rather than putting in long hours on the job. Consumers also want businesses to take more responsibility for environmental damage and social service-type concerns. Many competitors abroad continue to complain about the aggressive behavior of Japanese exporters and have asked their governments to counter these actions through protectionist measures.

In response to these internal and external messages some corporate leaders in Japan have begun to reconsider the ways Japanese industry conducts business. Their prescription for change includes a reduction of working hours and/or an increase in wages to improve the treatment of workers, more attention to shareholders' interests, increased contributions to society and more concern for environmental preservation. The calls for change are not unanimous, and that fact has stimulated a wide-ranging discussion about the risks of changing corporate practices that have helped make Japan a world economic power.

Change of some sort is likely, however, since demands from workers and foreign competitors could lead either to self-adjustment or, in the event of nonaction, to the possibility of more intervention by Tokyo in domestic business activities to achieve the results called for by both domestic and foreign critics. The latter result

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could halt ongoing efforts to liberalize Japanese markets and impact trade worldwide. Viewed in this light the calls heard at home for altering certain corporate management practices can be interpreted as an adaptive response by Japanese industry to revamp some of the ways it conducts business to prevent the spread of protectionism abroad, managed trade and new controls on business practices at home.

Current Japanese Corporate Management Practices

Corporate management practices in Japan have been described as one of the engines that have powered that country's comparatively fast economic expansion over the past three decades. Although the Japanese economy is based on capitalism, many analysts cite the supposed uniqueness of its corporate management philosophy to partially explain why Japan has achieved growth rates higher than those of other capitalist countries at various given times. And what usually strikes observers first is the priority corporate Japan has put on market share, whether at home or abroad. According to many economists, a focus on market share is a long-term, roundabout way to maximize profits — the presumed goal of business in a capitalist economy — and one that stands in sharp contrast to the short-term, direct profit-maximizing behavior of American and European companies.

The long-term, growth-oriented strategy of Japan's business sector as well as the flip side of this plan — in which returns to company stockholders, labor and management rank a distant second — are legacies of the immediate post-World War II period and the then tacit consensus that corporate Japan should plow most of its earnings into investment to expand the small role of Japanese industry first at home and later in the world market. This attachment to market share made particular profit-maximizing sense when overall economic growth was very rapid. Rules of thumb that developed to maximize profits — learned in the heady, expansionary days of the 1950s and 1960s — have continued to underpin Japanese business strategy to the present. The government encouraged this line of thinking, and still does, by taxing dividends heavily and capital gains lightly.

Employment practices that emphasize company unity and layoffs as a last resort provide additional support to the long-term strategy. Despite the absence of written contracts, permanent employees of big Japanese corporations can expect that once they have been recruited by a company they will remain with that firm until retirement. Employers treat employees like family members and invest training time and resources in them. Wages are based mainly on seniority rather than merit and, as a result, job switching among unaffiliated companies remains relatively unusual. Moreover, the average salaries of managers are not much higher than those of other employees of the same generation. Since promotion opportunities are, in principle, open to all employees, workers — like employers — tend to associate the company's growth with their own efforts and maturation.

Labor unions, too, often maintain cooperative relations with employers since they tend to be company-affiliated rather than industry-based. Except in some family-owned firms, corporate board members, including chief executive officers, typically are recruited from union ranks. The prospect that union leaders and members someday could be part of top management reinforces their interest in sharing and supporting the long-term corporate strategy. In addition, since a company's future growth is shared equally by managers and workers, employees are willing to put up with long hours and relatively low pay. Again, these labor practices made economic sense in times of high growth rates.

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The concept of family also extends in varying degrees to customer-supplier relationships. Large manufacturers have ties to small- and medium-sized parts suppliers not only in the production phase but also in the design and development stage. Often referred to as *keiretsu* relationships, these linkages might be through financial ties to one of Japan's nationwide commercial banks, pyramid-style industrial *keiretsu* that revolve around one major company or through vertical distribution arrangements (see *JEI Report* No. 2A, January 12, 1990). As is the case with employees, suppliers participate in these often grueling and sometimes low-profit relationships to gain a share of future growth.

Mutual and stable shareholding practices among *keiretsu*-member companies and other friendly institutional investors reinforce the long-term thinking of corporate managers. Since they do not have to be concerned about hostile takeovers, corporate managers do not worry about stockholders' short-term interests. With two exceptions over the past 15 years (1975 and 1989), the average ratio of dividends to after-tax corporate income in Japan has been around 30 percent, about half the figure for U.S. corporations (see Table).

Shares of Capital and Labor in National Income and Dividend Payout Ratio in Japan and the United States, 1970-89

	Corporate Fixed Investment/ GNP (constant prices)		Employees' Compensation/ National Income (current prices)		Dividends/ After-Tax Corporate Income (current prices)	
Year	Japan	United States	Japan	United States	Japan	United States
1970	17.4%	10.9%	54.0%	74.3%	16.6%	60.0%
1975	14.3	10.4	67.5	73.6	*	35.3
1980	14.5	11.9	66.8	74.3	29.1	35.9
1981	14.6	12.2	68.2	74.0	34.9	43.7
1982	14.3	11.6	68.6	75.7	30.5	62.8
1983	14.1	11.0	69.3	74.3	30.1	54.8
1984	15.1	12.1	68.9	73.1	26.7	54.1
1985	16.1	12.5	67.8	73.2	27.8	65.2
1986	16.4	11.8	67.9	73.6	29.6	79.2
1987	16.7	11.7	68.1	73.4	37.5	66.2
1988	18.1	12.1	67.7	72.9	36.7	60.9
1989	20.0	12.3	68.4	72.9	65.4	71.6

*Reported Japanese corporate income after taxes and dividends was negative.

Source: Department of Commerce, Bureau of Economic Analysis, and Economic Planning Agency

The list of factors shaping the long-term, growth-oriented strategy of Japanese business also includes the government's 1960s- and 1970s-era industrial policies and programs, which were designed to promote specific export-oriented industries over the long run. Although these practices have been much debated abroad (see *JEI Report* No. 29A, August 2, 1991), Japanese corporate executives are convinced that these initiatives and the close cooperation between government and industry they engendered were major influences on the way corporate Japan thinks and operates.

Whatever the influences these relationships have on industry's strategy, the results are most clearly evident in investment decisions. Here the pattern is clear. Japanese companies allocate a larger share of their net earnings to equipment and other fixed investments than do their American counterparts. The ratio of corporate fixed investment to gross national product in Japan exceeded the comparable U.S. figure by anywhere from 2.4 to 7.7 percentage points a year during the 1970s and 1980s. The ratio of Japan's privately funded research and development expenditures to gross national product was 2.2 percent in 1989; the same year the comparable U.S. figure was barely 1.5 percent.[1] Since a smaller proportion of national income historically has gone to wages in Japan than in the United States and a big gap traditionally has existed between dividend payout ratios in the two countries, Japanese companies have strong internal sources of financing. This, in turn, has allowed corporations to invest large amounts of money in plant and equipment as well as research and development without having to rely as much on financial markets as many non-Japanese firms do.

Change of Japan's Business Environment

Slowdown in Economic Growth - Given the economic and political environment in which Japanese companies will have to operate in the 1990s — such as the loss of the latecomer effect on productivity gains, the shortage of labor, the spread of trade and investment frictions abroad and the higher costs of capital, many economists forecast that Japan's average annual growth rate over this decade will slow to 3 percent at most in real terms (see *JEI Report* No. 11A, March 20, 1992). This period of slower growth is likely to be accompanied by an erosion in the previous fundamental templates of the long-term view of Japanese management. The new mentality suggests that if people no longer can expect continued fast economic growth or a more enjoyable lifestyle in the future, they have less reason to save for the future or to rely on what previously had been seen as assurances that delayed gratification would be rewarded.

The seniority system, for example, may have less relevance for salaried workers in the new environment. During the era of rapid growth employers could provide managerial posts in sufficient proportion to their expanding work forces. As the increase in corporate revenues slows, however, a company's average employee age rises since fewer new workers are entering the firm; the higher average age and less expansion limits promotion opportunities.

Another element of Japan's more developed society is an increase in the number of university graduates in the corporate work force. Thus, unlike a generation ago, a bachelor's degree no longer ensures a path into the high ranks of a company. Without being able to ensure that a sufficient number of management positions will be available, companies also are less able to attract younger workers by linking wage differences to seniority. Job-hopping among younger workers, including university graduates, is being reported, even in major corporations.

A public opinion poll conducted this past February by the Prime Minister's Office pointed to the tendency of younger salaried workers to place more importance on their personal lives than on the company's welfare.[2] The survey indicated that male workers in their 40s and 50s tended to regard work as more important than leisure, while those below 40 preferred leisure to work. Labor unions have begun to push for a reduction of working hours as well as higher wages and salaries. Since future pay increases are expected to be at a lower rate in line with the slowing of the Japanese economy, analysts anticipate that workers will be more concerned about improving their working conditions today rather than later, including working fewer hours and getting a greater share of corporate income.

Increasing Asset Gap - The huge run-up in land prices in the late 1980s widened the gap between Japan's haves and have-nots. In this situation pay increases could not catch up with soaring real estate prices. Until the real estate boom of the late 1980s salaried workers in their 30s or older could afford to purchase a home within a one-hour commute of major cities for around five times their annual salary. In spite of a recent drop in real estate prices (see *JEI Report* No. 14B, April 10, 1992), housing prices within the same commuting distances still are more than 10 times greater than the annual incomes of these workers. One effect of the bubble economy, in which speculation was rampant both in the stock market and in real estate, was to induce people to spend now rather than save for tomorrow.

Environmental Concerns - Consumers and the public in general are becoming more skeptical about the unintended effects of Japan's growth- and efficiency-oriented corporate strategy. Competition that leads to the development of more convenient goods at lower prices obviously benefits consumers, but costs also are imposed on society. For example, mass production also generates massive amounts of industrial garbage. Moreover, frequent changes in durable goods models, like cars, consumer electronics products and personal computers, induce consumers to purchase new products rather than to repair old ones. As a result, consumers scrap many still usable goods when they go out of style. This mentality increases the publicly borne costs of dealing with the scrap heap of a mass-consumption society, for example; what is perhaps more important, such thinking contributes to the inappropriate use of resources (see *JEI Report* No. 1A, January 10, 1992). Similarly, just-in-time delivery, which helps to control inventory costs, also has detrimental effects on the environment since it increases traffic and road congestion, which contribute to air pollution. Traffic accidents and other inconveniences also impose costs on society for the good of certain companies.

Deregulation - Government's export-oriented industrial policy no longer was appropriate by the 1980s when Japan started to rack up huge trade surpluses with many of its major trading partners year after year. Most government regulations and administrative guidelines that favored domestic companies were introduced when Japanese businesses still were weaker than their foreign competitors. Although these protective measures effectively fostered the growth of domestic industry for the first three decades of the postwar period, by the start of the 1980s companies in more mature sectors of the economy had begun to regard the web of regulations and guidance as an obstacle to their continued expansion. Less government intervention and liberalized markets became the preferred options for business, which for the last 10 years or so has supported administrative reform and greater deregulation of still controlled or cartelized sectors.

Overseas Market Complaints - When Japanese companies played a relatively minor role in world markets, and when those markets themselves were growing rapidly, corporate Japan had considerable leeway to expand exports and international market share. At the same time foreign companies appeared scarcely interested in their access to the limited Japanese markets, and those who were interested often faced various government-approved protective barriers, at least until the 1970s. As Japan's international market presence expanded, however, many foreign competitors began to be concerned. According to the International Monetary Fund, Japan's share of world GNP had reached 13.6 percent by 1989.[3] Among the members of the Organization for Economic Cooperation and Development Japan ranked as the second-largest exporter of manufactured products the same year with a 16 percent world market share; West Germany was first with a 19 percent stake. In fact, Japan's share of world manufactured exports was 18 percent between 1983 and 1985, more than two-and-a-half times larger than the same figure two decades before.[4]

Japan's international market share was trimmed in the second half of the 1980s by both the steep appreciation of the yen against the dollar and the export restraint arrangements forced on Tokyo by Washington and European capitals during that decade or even earlier. As of April 1991 U.S.-bound exports under "voluntary" restrictions by Japan on a volume basis included steel, cars, machine tools and textiles; quantitative limits also were in effect for forklift trucks, machine tools and textiles headed to the European Community market. Moreover, under the 1986 semiconductor trade agreement with the United States the Japanese government monitored the prices of key products exported to third countries as well as the United States.[5]

Outside Pressure - Such critics of Japan as the "revisionists" and certain foreign businessmen contend that a large part of Japan's trade surplus with the United States, the European Community and other countries stems from the uniqueness of Japanese corporate management and the close relationship between government and the private sector. They argue that although Japan's tariff and nontariff trade barriers largely have been dismantled, business practices there are exclusionary. Administrative guidance, too, works to prevent foreign companies from exporting to and investing in

Japan, these critics add. The 1989-90 Structural Impediments Initiative talks between Washington and Tokyo attempted to address these and other underlying causes of the huge U.S.-Japan trade gap. In the first year of follow-up sessions negotiators for the two governments spent more time on business-related issues, such as corporate management practices, *keiretsu* relationships, pricing practices and antitrust policy, than on public works spending or land reform.[6]

Moreover, foreign business executives blame corporate Japan for playing by a different set of rules at home that enhances their competitiveness abroad. For example, a Department of Labor survey of hours worked per employee in the manufacturing sector in 1989 showed that the average Japanese employee worked 2,155 hours a year, while on average American workers put in 1,951 hours, British workers 1,856 hours, French workers 1,610 hours and German workers 1,603 hours.[7] From this large discrepancy in working hours many foreign competitors conclude that Japanese businessmen profit handsomely from their employees' willingness to work. Although the number of hours worked says nothing about productivity, relative costs, or international comparative advantage, the impression conveyed by critics is that corporate Japan somehow benefits while its foreign counterparts suffer because their labor forces spend less time on the job. The underlying rationale of these foreign concerns for the Japanese laborer seems to be that the Japanese work force is being exploited (in terms of being paid less than warranted by its productivity). But lower labor costs permit lower prices, rather than higher profits. And lower prices allow Japanese products, in such situations, an unfair edge in dominating world markets. This argument suggests that, if Japanese corporate values force employees to sacrifice for the benefit of the company, then the conditions of employment tilt the balance on the trade playing field. Japanese business, thus, looks overly aggressive, with employees often described as trade warriors invading the world market. Although there is little in the way of empirical studies or theoretical research that could confirm or refute this argument, it is obvious from the discussions generated by this line of thinking that the anxieties can have political and economic consequences.

Reviewing Japan's Corporate Management

In responding to criticism from foreign government officials and industry leaders about how corporate Japan conducts business, Japanese negotiators have defended practices in Japan by stressing that the market there operates on the same capitalist principles as the American or European market does. Competition is the norm among companies regardless of their nationality, they say. Moreover, only a few government restrictions on foreign investors remain, even regarding acquisitions of Japanese companies, and Japan's tariff and nontariff trade barriers are among the lowest in the world.

Some Japanese business executives, however, have begun to take a hard look at foreign complaints about corporate Japan's market share strategy at home and abroad. For example, Keidanren (Japan Federation of Economic Organizations) recently proposed that Japanese companies work toward the development of cooperative relationships with consumers at home and their counterparts overseas.[8] Acknowledging that the business practices that served Japanese companies so well in the past may be no longer appropriate in a world where Japan is expected to take a more active role in international economic affairs and Japanese companies are being asked to pay more attention to community relations, the influential business group urged industry to promote a dialogue with labor union representatives and consumers as well as foreign business leaders.

In the February 1992 issue of the respected opinion magazine *Bungei Shunju* Sony Corp. cofounder Akio Morita created a sensation with a six-point proposal that he said he developed after a trip to Europe and the United States last year as a Keidanren vice chairman.[9] His article, available on newsstands in January, was the first public attempt by a Japanese businessman to address the need for fundamental change in Japanese corporate management practices.

Mr. Morita proposed that Japanese corporate managers should: try to reduce the number of hours worked to enable employees to enjoy more leisure time; raise wages and salaries; increase the dividends paid to stockholders; review both the just-in-time delivery system and pricing practices to improve relations with suppliers; play a more active role in community and philanthrophic activities as good corporate citizens; and become more concerned about environmental preservation, through reduced energy consumption, among other measures. Mr. Morita also suggested an overhaul of Japanese corporate strategy. Instead of trying to sell the largest volume possible regardless of the profit margin earned, manufacturers should concentrate on marketing smaller volumes of higher profit products, he said.

Various reactions to Mr. Morita's proposal have reverberated in Japan's business and academic circles. The head of Nikkeiren (Japan Federation of Employers' Associations) promptly cast doubt on whether changes in Japanese corporate management practices would help employees realize a better life or ease tensions with foreign business competitors.[10] Takeshi Nagano, who also heads Mitsubishi Materials Corp., argued that raising employees' wages or salaries and shareholders' dividends would undermine the competitiveness of Japanese firms. A correspondingly weaker Japanese economy could not meet international expectations that it recycle its trade surplus for the benefit of world economic development, he added. Mr. Nagano further stated that international criticism of Japan stemmed not from Japanese management practices but from the perception that Japan did not fulfill its role as an economic superpower. He also noted that the Japanese people could attain a higher standard of living through measures other than higher pay, which would raise concerns about inflation. He suggested that gains could be made by improving the country's social and economic infrastructure, such as transportation networks, and implementing land reforms that would lower the cost of doing business in Japan.

Some commentators say that Mr. Nagano's views represent the general position of Nikkeiren. That organization is nervous about big wage and salary increases at a time when the Japanese economy is growing relatively slowly.[11] At least one businessman suggested, though, that Mr. Nagano had a personal reason for not backing Mr. Morita's idea that corporate Japan should abandon its drive for market share.[12] Mitsubishi Materials generates nearly half of its revenues from copper, zinc, gold, silver and cement. Unlike the consumer electronics products that make up most of Sony's business, primary metals and cement are undifferentiated products sold at prevailing world market prices; the principal means for increasing profits in such products is through higher sales and revenues rather than through product improvements.

In analyzing whether Mr. Morita's idea would sap the vitality of Japanese companies, Rikkyo University Emeritus Prof. Chiaki Nishiyama pointed out that, given Japan's projected long-term labor shortage, reducing the number of hours production workers put in would have to be offset by more extensive automation if real unit labor costs were not to increase.[13] If employees and stockholders were to receive more of a company's net profits in the form of higher wages and dividends, respectively, the firm would have less money from internal sources to fund capital investment and R&D expenditures. Mr. Nishiyama concluded that the competitiveness of Japanese industry would be lessened if corporate managers proceeded to reduce working hours and raise employee compensation and, at the same time, boost the dividend payout ratio.

Mr. Nishiyama's criticism implicitly assumes that Japanese firms are reluctant to raise funds externally. The reason could be simple. Raising funds through stocks, bonds or borrowing usually costs a company more than tapping its own internal sources of financing, especially with the present corporate tax structure. A recent article in the *Economist* suggested that Japanese management may pay little attention to the cost of capital in making investment decisions; these, the author said, are driven more by market share opportunities.[14] This assertion was more true of the past than of the present since Japanese companies now increasingly are confronting real market cost of funds. Other studies on the cost of capital itself have indicated that the advantage Japanese corporations once might have had in raising funds now has disappeared (see *JEI Report* No. 16A, April 20, 1990). In any case greater dependence on external market-priced sources of financing would contribute to a long-run leveling out of Japanese competitiveness (see *JEI Report* No. 11A, March 20, 1992).

Ironically, at the same time that leading Japanese businessmen are questioning the future viability of their past methods, a cross section of politicians, government officials, businessmen and academics in the United States argues that American companies should operate more like their Japanese counterparts. For example, the Competitiveness Policy Council, established by the 1988 Omnibus Trade and Competitiveness Act, proposed several measures at the beginning of March to bolster this country's competitiveness.[15] The group recommended that American corporate managers pay more attention to long-term profits than short-run returns and strengthen relations with shareholders as well as employees, suppliers and the communities in which they operate. (Other proposals included: legislative measures to induce companies to change the way they do business; incentives to boost personal savings; improved educational and vocational training; and more support for business R&D and export programs.)

Many Japanese and foreign analysts have questioned whether implementation of Mr. Morita's plan would lower the rhetoric level in the West.[16] Even if Japanese companies operated more like American and European corporations, these analysts say, foreign businessmen still might not be satisfied if the Japanese market continues to appear closed. A similar concern is that if Japan fails to meet international expectations of its political role in the world community, then actions by the private sector at home and abroad still will fall short of demands for change.

Self-Policing Versus Government-Imposed Changes

Government initiatives, like land reform, deregulation of the distribution system and expanded social infrastructure, are necessary before the Japanese public begins to feel that its standard of living is comparable to what Americans and Europeans have. Recommendations along these lines have come from abroad through such channels as the SII talks as well as from domestic sources, like Mr. Nagano of Nikkeiren. But relying on the government for change also has costs. The private sector would say that one potential major cost would be that industry's activities might be more constrained than they otherwise would be. If, for example, traffic jams result primarily from frequent deliveries to factories or shops that have a just-in-time inventory system, residents living nearby could ask the government to restrict road usage. Similarly, if people are worried about the social costs of industrial or household waste, the government might be able to tackle the problem by restricting production or taxing producers and consumers to simultaneously encourage changes in disposal habits and cover the disposal costs. Corporate executives would argue, though, that greater regulation of business activities is likely to raise production costs, a result that eventually will show up in the prices consumers pay.

Voluntary self-policing is among the approaches that Japanese business leaders and many consumers are advocating to solve problems such as those just mentioned. If corporate managers always take into account community interests, they can voluntarily restrict their business activities without government intervention. Although this alternative, too, probably would lead to price hikes on certain products, the increased administrative costs stemming from additional regulatory controls would be eliminated. Many Japanese companies, therefore, have adopted on their own codes of conduct regarding corporate behavior — especially related to the issue of environmental preservation.[17] In addition, more corporations are exploring philanthropic activities to elevate the company's image in the community.[18]

Companies also increasingly are seeing a need to bring their management practices more in line with those of foreign competitors. Further government intervention in the business community's affairs is expected unless business leaders move quickly. Some Japanese businessmen worry that Japan-targeted protectionist measures, such as import surcharges or market-sharing arrangements, might proliferate if trade tensions with the United States and Europe continue at their present levels. President Bush's early January visit to Tokyo exemplified the tendency of some American businessmen to rely more on government-to-government negotiations rather than on private-sector talks. Japanese business leaders concerned about calls for managed-trade types of solutions see frequent government intervention in trade and investment activities as eventually leading down that path or (in an extreme version) to a command-type of economy, such as that found in the collapsed economies of the former Soviet Union and Eastern European nations. Government intervention, in any case, narrows trade opportunities by undercutting market mechanisms.

Japan's corporate leaders view self-initiated change as worth the effort, a way of demonstrating their intention to compete in a more acceptable way in world markets. Not only do they see themselves as thus maintaining a market economy but avoiding protectionist responses overseas. The feasibility of their efforts and whether changes would address the main concerns of critics at home and abroad — thereby heading off future problems — remain open to debate.

For more information, contact **Tadashi Saito.**

Notes

[1] Science and Technology Agency, *Kagaku Gijutsu Hakusho 1991* (White Paper on Science and Technology).

[2] Prime Minister's Office, *Yoka to Ryoko ni Kansuru Yoron-chosa* (Public Opinion Poll on Leisure and Travel), February 22, 1992.

[3] Estimate by the Economic Planning Agency based on International Monetary Fund statistics, including data appearing in *World Economic Outlook* (October 1990) and *International Financial Statistics.*

[4] Organization for Economic Cooperation and Development, *Foreign Trade by Commodities* (various years).

[5] Ministry of International Trade and Industry, *Tsusho Hakusho 1991* (White Paper on Trade).

[6] *First Annual Report of the U.S.-Japan Working Group on the Structural Impediments Initiative,* May 22, 1991.

[7] Department of Labor, Bureau of Labor Statistics, *Underlying Data for Indexes of Output per Hour, Hourly Compensation, and Unit Labor Costs in Manufacturing, Twelve Industrial Countries 1950-1989,* May 1991.

[8] Keidanren, *A Guide to Action for 1992,* January 30, 1992.

[9] Akio Morita, "Nihon-gata Keiei ga Abunnai (Crisis of Japanese Corporate Management)," *Bungei Shunju,* February 1992.

[10] Mr. Nagano publicly opposed Mr. Morita's views at a January 20, 1992 Nikkeiren press conference. Mr. Nagano's position was outlined in "Towareru Nihon-gata Keiei (Japanese Corporate Management under Challenge)," *Yomiuri Shimbun,* February 6, 1992.

[11] See such newspaper articles as "Nikkeiren shuno no Gyakushu (Counterattack by Leaders of Nikkeiren)," *Nihon Keizai Shimbun,* January 21, 1992, and "Ronso-Nihon Kigyo no Chingin Suijun wa? (A Debate on Japan's Wage Levels)," *Asahi Shimbun,* January 28, 1992.

[12] Ken Moroi, chairman of Chichibu Cement Co., Ltd., as quoted in *Sentaku,* March 1992.

[13] Chiaki Nishiyama, "Seisansei Mushi no Jitan wa Mondai (Problems of Shortening Working Hours Without Considering Productivity)," *Yomiuri Shimbun*, March 22, 1992.

[14] "Japanese Business Methods," *The Economist*, April 4, 1992.

[15] Competitiveness Policy Council, *First Annual Report to the President and Congress: Building A Competitive America*, March 1, 1992.

[16] See, for example, "Nihon-gata Keiei no Yukue, Morita Ronbun wo Do yomuka (Prospects for Japanese Corporate Management: How Do We Interpret Morita's Proposals?)," *Bungei Shunju*, April 1992.

[17] Keidanren, *Keidanren Global Environment Charter*, April 23, 1991.

[18] Keidanren, "Shakai Koken Hakusho (White Paper on Japanese Corporate Philanthropic Activities)," January 28, 1992.

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REPORT

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JAPAN AIMS FISCAL WEAPONS AT ECONOMIC GROWTH: BULLETS OR BLANKS?

SUMMARY

After enjoying several years of bountiful revenues, Japanese fiscal planners face hard times as the speculative financial excesses of the late 1980s are wrung out of the economy. At the same time that revenues are shrinking, domestic and foreign pressures on Japanese fiscal policy are building for ever greater spending. Fiscal planners, loathe to surrender the hard-won cuts in the budget deficit achieved through FY 1990, are seeking new revenue sources. But with few promising candidates in sight, the government is watching each yen with renewed vigor. If Tokyo cannot employ fiscal tools to invigorate its own economy, observers wonder, how can the Japanese government expect to play a larger role in solving costly international problems? Thus, Japanese fiscal policy faces rising expectations against a backdrop of dwindling resources.

Background

From the end of the U.S. occupation through the early 1970s the Japanese government's approach to managing overall economic growth can be characterized as monetarist. Careful controls on money supply growth, bank lending and foreign exchange reserves largely set the boundaries for economic activity. The economy experienced an excess of demand in this period as the nation strove to rebuild its war-torn industries and economic infrastructure. Monetary policy, thus, was used more as a brake on economic activity than as a prod. Fiscal policy was given the dual tasks of raising the level of industrial technology and creating the infrastructure (transportation and communication networks, for example) to support industrial reconstruction.

With the reconstruction process mainly complete by the early 1970s, several Japanese industries had emerged as world-class competitors. The end of fixed exchange rates in 1971 and the 1973-74 oil shock severely shook this rebuilt industrial structure. Faced with stagnating demand and rising inflation, which could not be addressed by an easier monetary policy alone, Tokyo adopted a standard Keynesian remedy — deficit spending. Government bond issues surged as the government attempted to spend its way out of the slump. By the end of the decade, however, officials realized that the double-digit growth rates enjoyed in the 1950s and 1960s were unachievable by Japan's larger and more mature economy. The surge in deficit spending, moreover, had left a legacy of a large outstanding debt to be serviced, a problem new to Japanese planners.

In the 1980s worry over the budget deficit and the outstanding debt generated a consensus that the government not only must bring the current deficit under control but reduce the mountain of outstanding debt. The Ministry of Finance began by initiating a policy in FY 1987 of selective austerity — combining moderate increases in discretionary general account spending with a rapid reduction of new borrowing — to help whittle down the deficit. Late that year strong economic growth, facilitated by monetary growth and driven by solid consumer spending and rapidly expanding private capital investment, proved strong enough to generate tax revenue growth well above the levels forecast by budget planners. This revenue bounty allowed Tokyo to eliminate new issues of deficit-financing bonds as of FY 1990.

Despite — or in addition to — its successes in the management of debt and deficit, Tokyo's combination of stimulative and contractive fiscal measures has worked to limit the public sector's role in overall economic growth. Tokyo still influences economic activity in several ways, however. The government can cut or raise taxes selectively; boost spending via supplemental appropriations (as was done in late 1987 to counter the negative effects of the yen's sharp appreciation against the dollar); reallocate general account funds to favor specific areas (as has been done for foreign aid); and focus outlays of the Fiscal Investment and Loan Program, the major source of capital spending, to stimulate desired areas of economic activity (greater public works spending and bigger foreign aid budgets, for example). While all these options are employed in the FY 1992 central government fiscal plan, the debate is growing over their effectiveness.

The General Account

The centerpiece of Japanese fiscal policy traditionally has been the general account budget since it funds the current operations and activities of the central government. Because line items in the general account budget represent direct spending and are highly visible, they play a major role in both the psychological and the real aspects of fiscal policy. Moreover, the policy of selective austerity shows most clearly in the general account.

Expenditures - There is a clear break between FY 1990 and FY 1991 in the pattern of overall growth of general account spending (see Table 1). From FY 1987 through FY 1990 the rise in aggregate spending easily outpaced the expansion of gross national product. This charged performance stemmed mainly from the uncontrollable growth of mandatory payments (see Table 2) — transfers to local governments, which are a fixed percentage of specific central government taxes and therefore rise in step with the growth of general tax revenues, and interest costs on the national debt, which are determined partly by the amount of outstanding debt the government must roll over and partly by current interest rates. In contrast, the expansion of discretionary outlays modestly surpassed the rate of inflation prior to FY 1990 but fell short of the rate of overall economic growth. In FY 1990 discretionary spending was flat as MOF pushed particularly hard to hold down expenditures to compensate for the nearly 20 percent jump in interest payments on the national debt and to achieve its cherished goal of halting new issues of deficit-financing bonds. Also in FY 1990 and FY 1991 budgeteers had to contend with Tokyo's pledge to contribute a total of about $13 billion to the multinational operation set up to free Kuwait from the occupying Iraqi army. Squeezing this large contribution into an already tight budget took accounting as well as political skill.

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Table 1: **Japan's General Account Expenditures (Revised), FY 1988-FY 1992***

(in billions of yen and percent change)

	FY 1988		FY 1989		FY 1990		FY 1991		FY 1992**	
Total Expenditures	¥61,851.7	6.3%	¥66,311.9	7.2%	¥69,651.2	5.0%	¥70,613.5	1.4%	¥72,218.0	2.7%
Social Security	11,801.4	14.3	12,474.2	5.7	11,544.6	-7.5	12,196.2	5.6	12,737.4	4.3
Public Assistance	1,062.0	-3.9	1,080.6	1.8	1,050.8	-2.8	1,018.2	-3.1	1,061.3	-1.2
Social Welfare	2,146.3	5.6	2,309.7	7.6	2,446.8	5.9	2,634.0	7.7	2,818.8	8.8
Social Insurance	7,732.3	22.5	8,203.4	6.1	7,204.8	-12.2	7,646.4	6.1	7,888.4	3.8
Health Services	500.7	-2.3	526.4	5.3	561.8	6.7	600.5	6.9	641.1	5.3
Unemployment Compensation	360.2	-1.2	354.1	-1.7	280.5	-20.8	297.1	5.9	327.7	-3.2
Education and Science	4,982.0	-1.6	5,075.3	1.9	5,359.4	5.6	5,562.7	3.8	5,688.4	5.4
Compulsory Education	2,463.5	3.0	2,475.5	0.5	2,642.6	6.8	2,768.4	4.8	2,726.3	3.3
Transfer to School Account	1,124.4	-4.7	1,184.8	5.4	1,264.3	6.7	1,304.8	3.2	1,379.6	9.0
Science and Technology Promotion	426.6	-9.9	453.9	6.4	474.2	4.5	499.1	5.3	547.8	8.0
School Facilities	283.3	-20.1	262.7	-7.3	244.3	-7.0	254.4	4.1	271.9	9.4
School Aid	601.0	3.5	615.4	2.4	650.3	5.7	649.5	-0.1	668.8	3.3
Student Loans	83.3	2.0	83.0	-0.4	83.7	0.8	86.5	3.3	88.9	2.5
Public Works	6,683.0	-10.0	7,398.9	10.7	7,013.2	-5.2	7,343.4	4.7	8,024.3	21.8
Erosion and Flood Control	1,059.4	-13.3	1,080.6	2.0	1,087.3	0.6	1,147.3	5.5	1,415.8	23.4
Road Improvement	1,744.1	-12.1	1,782.6	2.2	1,789.2	0.4	1,900.1	6.2	2,289.4	20.5
Harbors and Airports	497.1	-12.8	511.5	2.9	515.0	0.7	545.0	5.8	645.0	18.4
Housing	930.3	-3.5	1,539.2	65.5	930.9	-39.5	974.7	1.8	930.8	15.1
Social Infrastructure	942.6	-14.8	954.9	1.3	957.4	0.3	1,034.5	8.1	1,340.1	29.5
Agricultural Infrastructure	852.4	-11.5	867.8	1.8	870.5	0.3	910.1	4.5	1,103.6	21.3
Forestry and Industrial Water Supplies	163.0	-10.0	169.1	3.7	157.8	-1.5	165.8	5.1	218.4	31.7
Disaster Reconstruction	483.8	12.1	482.3	-0.3	694.7	44.0	654.6	-5.8	68.2	0.0
Reserves	10.4	-11.9	10.9	4.8	10.6	0.2	11.2	5.7	12.9	15.2
Pensions	1,879.8	-0.8	1,855.7	-1.3	1,837.4	-1.0	1,808.3	-1.6	1,783.9	-1.4
Civil Servants	118.1	-3.4	111.8	-5.3	107.8	-3.6	104.7	-2.9	101.5	-3.1
Veterans	1,599.0	-0.5	1,588.5	-0.7	1,580.5	-0.5	1,560.8	-1.2	1,547.5	-0.9
Other Pensions	154.4	-2.0	147.4	-4.5	141.0	-4.3	134.6	-4.5	128.7	-4.5
Administrative Costs	8.4	-5.6	8.0	-4.8	8.0	-0.2	8.1	1.3	6.2	-24.4
Local Finance	13,031.2	17.5	14,964.7	14.8	15,930.8	2.8	15,800.2	-0.8	15,771.9	-1.3
Local Allocation Tax	13,031.2	17.5	14,964.7	14.8	15,930.8	2.8	15,800.2	-0.8	15,771.9	-1.3
Interest Support and Special Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
National Debt Service	12,030.7	1.5	12,089.8	0.5	14,449.3	19.5	15,536.6	7.5	16,447.3	2.6
Defense	3,728.3	6.3	3,969.9	6.5	4,254.1	7.2	4,440.0	4.4	4,551.8	3.8
Economic Cooperation	714.4	8.0	750.6	5.1	802.0	6.8	864.8	7.8	905.1	7.0
Small Business Assistance	257.6	-2.1	240.5	-6.6	240.9	0.2	214.6	-10.9	195.6	0.3
Energy Support	458.4	-7.7	546.1	19.1	547.1	0.2	589.3	7.7	631.3	6.6
Food Agency Account	480.4	-30.2	459.2	-4.4	404.6	-11.9	381.5	-5.7	342.1	-8.3
Miscellaneous	4,304.6	0.3	4,987.1	15.9	5,642.7	13.1	4,425.9	-21.6	4,577.3	5.1
Salary Increase Reserve	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	135.0	n.a.	0.0	-100.0
Reserves	200.0	0.0	200.0	0.0	325.0	62.5	150.0	-53.8	350.0	133.3
Industrial Investment Special Account	1,300.0	183.8	1,300.0	0.0	1,300.0	0.0	1,300.0	0.0	216.6	-83.3
Persian Gulf Contribution***	n.a.	n.a.	n.a.	n.a.	(1,300.0)	n.a.	300.0	n.a.	n.a.	n.a.

*Revised budget figures include the supplementary budget.
**Initial budget. Percent changes are based on the initial budget for FY 1991.
***¥1.3 trillion was appropriated in two supplemental budgets and included under Miscellaneous. The FY 1991 amount actually was disbursed in FY 1990.

Source: Ministry of Finance

On a line-item basis selective fiscal austerity clearly remains in effect for the budget year that began April 1. At the heart of the austerity drive is an informal MOF rule issued in FY 1986 under which every government agency has to cap capital outlays and reduce by 10 percent its current operating costs. Despite this tough guideline, the fate of each category in Table 1 largely is determined by hard-fought negotiations between MOF and other agencies in every budget cycle. The Finance Ministry has proved tough but not inflexible; no budget item has been cut consistently, but few items have escaped MOF's "negative ceiling" rule unscathed.

Political factors figure heavily in budget negotiations. Defense and foreign aid have been accorded special treatment because of strong foreign pressure for greater spending in these areas. With the exception of FY 1989, economic cooperation, for example, has been granted increases of 6 percent or more since FY 1987. Energy programs, out of favor in the mid-1980s, recaptured Tokyo's attention following the Persian Gulf crisis. Until FY 1991 defense spending also had registered above-average gains of 6 percent-plus annually. The end of the Cold War and the rapid disintegration of the Soviet Union, however, ended the charmed life of defense outlays and starkly illustrated that a loss of political importance usually is followed by funding cuts. While foreign pressure may tip the balance of budget negotiations in any one category's favor, it is not sufficient to guarantee year-to-year growth. The budget for public works, for example, has been volatile despite steady American pressure on Tokyo to spend more in this area.

Among the least glamorous but most demanding budget items is the cost of servicing the national debt. In the initial FY 1992 budget this category gains the dubious distinction of being the largest line item, even though at an expected ¥16.4 trillion-plus ($121.8 billion at ¥135=$1.00) or 22.8 percent of total general account spending, it will be up only 2.6 percent. That projection contains good and bad news. The actual interest component of this item will just top ¥15 trillion ($111.1 billion), a gain of 7.1 percent over FY 1991's ¥14 trillion mark ($103.7 billion). The remainder (¥1.4 trillion or $10.4 billion) will be used to redeem some of the outstanding debt. Although this will be the third year in a row that MOF plans to retire debt, the portion targeted for FY 1992 is no greater than the year before. MOF analysts hope that the Bank of Japan's April 1 discount rate cut and other measures that lower interest rates will cut the cost of refinancing the debt and improve the buy-back figure.

Transfers to local governments, the other main component of nondiscretionary funding, presents a case study of not only the constraints facing MOF when revenue prospects are restricted but how the ministry responds in such situations. Under Japanese law the central government distributes to local governments a fixed percentage of the personal income, corporate income, liquor, tobacco and consumption taxes it collects. Furthermore, revenues from gasoline, vehicle tonnage and aviation fuel taxes are distributed to local governments according to the amount of vehicle and plane traffic they support. (See *JEI Report* No. 41A, November 1, 1991 for a detailed review of local government.) As central government revenues boomed in the late 1980s, so did local revenue-sharing. The converse now is true, too. As taxes collected by Tokyo have dropped, the growth of local transfers has halted. MOF accelerated the reversal even further in FY 1992 when it reduced the percentages used to calculate local transfers. Finance officals justified the change in the formerly sacrosanct formulas by arguing that local government coffers are so full after several years of massive transfers that the money cannot all be spent. It is not clear if MOF's adjustments are permanent, but they do illustrate the degree of pressure MOF budget planners face.

Japan's nearly $9 billion second contribution to the U.S.-led multinational forces that ended Iraq's occupation of Kuwait provided a unique twist to both the FY 1990 and the FY 1991 budgets. This second contribution, which at the time it was pledged amounted to ¥1.17 trillion, was appropriated in FY 1990 via a second supplementary budget. It was financed mainly by a special bond issue, which was to be redeemed in a year with revenues from special, temporary levies on corporate income and petroleum imports, and a delay in the reduction of other taxes. To prevent a skewed analysis of budget trends MOF has tried to keep the Persian Gulf contribution and its related funding measures separate from standard appropriations.

Table 2: **Japan's Discretionary General Account Spending (Revised), FY 1988-FY 1992***

(in billions of yen and percent change)

	FY 1988		FY 1989		FY 1990		FY 1991		FY 1992**	
Total Expenditures	¥61,851.7	6.3%	¥66,311.9	7.2%	¥69,651.2	5.0%	¥70,613.5	1.4%	¥72,218.0	2.7%
Minus										
Debt Service and Transfers to Local Governments	25,061.9	9.3	27,054.5	8.0	30,380.1	12.3	31,366.8	3.2	32,219.2	-2.7
Equals										
Discretionary Spending	36,789.8	4.3	39,257.4	6.7	39,271.1	0.0	39,276.7	0.0	39,998.8	7.4

*Revised budget figures include the supplementary budget.
**Initial budget. Percent changes are based on the initial budget for FY 1991.

Source: Ministry of Finance

Table 3: **Japan's General Account Revenues (Revised), FY 1988-FY 1992***

(in billions of yen and percent change)

	FY 1988		FY 1989		FY 1990		FY 1991		FY 1992**	
Total Revenues	¥61,851.7	6.2%	¥66,311.9	7.2%	¥69,651.2	5.0%	¥70,613.5	1.4%	¥72,218.0	2.7%
Tax and Stamp Revenues	48,106.0	11.7	54,227.0	12.7	59,131.0	9.0	58,990.0	-0.2	62,504.0	1.2
Direct Taxes	36,284.0	14.5	41,541.0	14.5	44,842.0	7.9	43,196.0	-3.7	45,821.0	-2.6
Income Taxes	16,928.0	4.6	20,057.0	18.5	24,345.0	21.4	25,738.0	5.7	27,279.0	6.0
Withheld	12,675.0	3.0	15,020.0	18.5	18,280.0	21.7	20,095.0	9.9	21,288.0	5.9
Self-Assessed	4,253.0	9.5	5,037.0	18.4	6,065.0	20.4	5,643.0	-7.0	5,991.0	6.2
Corporate Taxes	17,712.0	29.1	19,577.0	10.5	18,637.0	-4.8	17,458.0	-6.3	18,122.0	-5.9
Special Surtax	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	404.0	n.a.
Inheritance and Gift Tax	1,644.0	-8.3	1,907.0	16.0	1,860.0	-2.5	2,046.0	10.0	2,260.0	10.5
Land-Holding Tax	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	420.0	n.a.
Indirect Tax Revenues	11,822.0	3.9	12,686.0	7.3	14,289.0	12.6	15,794.0	10.5	16,683.0	13.3
Consumption Tax	n.a.	n.a.	3,618.0	100.0	4,870.0	34.6	4,944.0	1.5	4,968.0	0.5
Commodity Tax	1,906.0	13.1	0.0	-100.0	0.0	0.0	0.0	0.0	0.0	0.0
Liquor Tax	2,066.0	1.2	1,801.0	-12.8	1,914.0	6.3	2,000.0	4.5	2,025.0	1.3
Tobacco Excise Tax	1,011.0	-0.1	932.0	-7.8	957.0	2.7	987.0	3.1	1,012.0	2.5
Gasoline Tax	1,314.0	-17.7	1,365.0	3.9	1,423.0	4.2	1,503.0	5.6	1,576.0	4.9
Petroleum Tax	290.0	52.6	438.0	51.0	453.0	3.4	490.0	8.2	507.0	3.5
Motor Vehicle Tonnage Tax	532.0	9.5	559.0	5.1	628.0	12.3	640.0	1.9	674.0	5.3
Securities Transaction Tax	1,800.0	1.9	1,234.0	-31.4	1,020.0	-17.3	492.0	-51.8	615.0	-39.7
Customs Duty	703.0	17.4	759.0	8.0	864.0	13.8	850.0	-1.6	879.0	3.4
Other	227.0	12.9	131.0	-42.3	134.0	2.3	139.0	3.7	134.0	-3.6
Stamp Revenue	1,973.0	9.2	1,849.0	-6.3	2,026.0	9.6	1,703.0	-15.9	1,663.0	-22.6
Monopoly Profits	8.0	33.3	7.7	-3.8	8.3	7.8	8.6	3.6	10.1	17.4
Public Enterprise Receipts	16.7	-4.6	16.9	1.7	17.6	4.1	19.0	8.0	18.9	-0.5
Sale of Public Properties	126.1	-30.2	173.3	37.5	128.5	-25.9	127.2	-1.0	109.3	-14.1
Miscellaneous	1,353.5	-14.7	2,385.4	-10.1	2,505.3	5.0	3,234.7	29.1	2,211.5	-25.7
Public Bonds	7,967.0	-24.4	7,111.0	-10.8	7,312.0	2.8	6,730.0	-8.0	7,280.0	36.3
Construction	6,196.0	-9.9	6,430.0	3.8	7,312.0	2.8	6,730.0	-8.0	7,280.0	36.3
Deficit-Financing	1,771.0	-51.6	681.0	-61.5	0.0	-100.0	0.0	0.0	0.0	0.0
Carryover Surplus	2,974.6	27.2	2,390.6	-19.6	548.6	-76.5	1,503.9	174.1	84.3	-17.3

*Revised budget figures include the supplementary budget.
**Initial budget. Percent changes are based on the initial budget for FY 1991.

Source: Ministry of Finance

Among discretionary spending categories public works stands out clearly in the FY 1992 initial budget for its unusually large increase of 21.8 percent. Tokyo's response to the lagging domestic economy has focused on public works spending but, despite the big initial increase, domestic and foreign critics charge that it will not be enough to jump start the sputtering economy. Even a larger increase, some argue, may not be effective, implying that fiscal policy has lost its punch to stimulate the world's second-largest economy. Public works spending for all of FY 1992 no doubt will be bolstered further by a hefty supplemental budget if the economy indeed fails to show signs of renewed vigor by the fall. The debate over fiscal policy's efficacy, however, will not fade away.

The other notable discretionary item is the modest 3.8 percent increase penciled in for defense spending in FY 1992. This small gain is due in part to the end of the Cold War and in part to Japan's Persian Gulf contribution. A cut in defense spending was an element of the deal struck by the government with opposition parties to finance the donation. It remains to be seen whether slower growth will become a lasting characteristic of defense outlays.

Revenues - The revenue plan outlined in Table 3 shows that, for the third year in a row, the government will finance operating expenses out of taxes and other revenue sources in FY 1992 and borrow only to fund capital expenditures. In a time of shrinking tax revenues and growing fiscal demands, however, eliminating new issues of deficit-financing bonds carries a price: a sharp 36.3 percent jump in the amount of new construction bonds to be issued. Viewed in terms of absolute amounts, FY 1992's initial projection of ¥7.3 trillion ($53.9 billion) for new project bonds is slightly lower than the figure of two years ago. (With exchange rate changes factored in, the FY 1990 amount was lower in dollars, $51.2 billion.) In terms of the percentage of total revenues, however, FY 1992's 10.1 percent figure compares favorably with ratios in FY 1990 and FY 1991 when construction bonds bore the full load of government's debt financing at 10.5 percent and 9.5 percent, respectively. MOF clearly is keeping a tight rein on the budget deficit, no matter how intense the pressure for an expansive fiscal policy.

Slumping corporate tax receipts in the current fiscal year will inadvertently assist MOF's drive toward its goal of reducing the role of direct taxes in the composition of revenues. Unfortunately, from MOF's viewpoint, direct taxes are expected to account for 63.4 percent of revenues in FY 1992, up from FY 1991's 61.2 percent level thanks to higher receipts from individuals' taxes. MOF analysts are concerned that corporate and individual income taxes concentrate the tax burden unfairly on companies and their employees (who pay taxes via withholding). Indirect taxes can be targeted with greater precision and have less apparent psychological impact on taxpayers than direct levies, they say. Critics dispute these arguments, pointing to the generally regressive nature of indirect taxes and the strong negative reaction by consumers to the April 1, 1989 introduction of a consumption tax.

Paradoxically, indirect taxes' share of total revenues is expected to grow in FY 1992 to 23.1 percent from FY 1991's 22.4 percent, although the category with the greatest projected input has a weak history. A close look at Table 3 reveals that revenues from the controversial consumption tax, which was supposed to reverse the increasing reliance on direct taxes, are expected to drop from 19.2 percent of personal income taxes to 18.2 percent, far behind expectations. Despite tougher monitoring by MOF and more frequent payments (quarterly instead of semiannually), collections through January (10 months of FY 1991) had reached just 47 percent of the fiscal year's projected total of ¥4.9 trillion ($36.3 billion). This experience portends a dim outlook for the growth of consumption tax receipts.

Slower domestic economic activity also spells bad news for other indirect taxes levied on items linked to consumer spending, such as liquor, tobacco and gasoline. The sharpest reversal, however, is expected to come in receipts expected from stock trading. After booming through FY 1987, revenues from this tax have plummeted. With recent trading volumes on organized stock exchanges and over-the-counter way below their peaks of the late 1980s, budget planners realize that the windfall from this source has ended.

Table 3 also indicates that tax equity suffered in FY 1991 and may suffer again in FY 1992. Individuals are expected to bear more of the tax burden for the second consecutive year, a development counter to the consumer-oriented policies adopted by the government in the late 1980s. Personal income taxes provided 59.6 percent of direct tax revenue in FY 1991, well above the most recent high of 55.6 percent recorded in FY 1986 and sharply up from FY 1990's 54.3 percent level. The share held by workers is projected to remain high in FY 1992 at 59.5 percent. At the same time the corporate tax burden continues to fall from its recent high of 48.8 percent in FY 1988 to 40.4 percent in FY 1991 and an expected 39.5 percent in the current fiscal year.

Equity among individual taxpayers also remains an issue, since oversight is minimal in a tax system that allows the self-employed (politically powerful farmers, small shop owners and professionals among them) to avoid taxes. Self-employed professionals historically top the National Tax Agency's annual list of tax cheats, yet the group as a whole still accounts for about one-fifth of total individual income tax revenues. Although the FY 1992 forecast shows that receipts from individuals paying self-assessed taxes are expected to grow slightly faster than receipts from individuals who pay through withholding — 6.2 percent versus 5.9 percent, popular discontent with the system surely will grow, particularly as the government continues to promote consumer spending and a higher standard of living.

Another prospective area of change is the revenue windfall on which Japanese fiscal planners previously have counted — the sale of government-held shares of former public monopolies. Between FY 1988 and FY 1991 prior sales of Nippon Telegraph and Telephone Corp. shares added an extra ¥1.3 trillion ($9.6 billion) a year to public works spending. In the initial general account budget for FY 1992, however, this item has been pared back to just ¥216.6 billion ($1.6 billion). Because public disenchantment with high-priced shares and volatile equity markets have forced the government to postpone new offerings of NTT stock, MOF has not been able to replenish this particular kitty. The government has hopes of selling some of its stock in Japan Tobacco Inc. and the Japan Railways Group, but this depends on the state of equity markets, which is not receptive at this time. In the long run the limited number of shares the government owns of former public monopolies or is planning to sell ultimately limits this revenue source. MOF officals have given no hints on how they plan to replace these revenues.

Fiscal Investment and Loan Program

For the sixth consecutive year Japan's capital budget will set a spending record in FY 1992 (see Table 4). At ¥40.8 trillion ($302.2 billion) outlays will be equivalent to 56.5 percent of the initial general account, keeping them at more than half of the preliminary general account for the fourth straight year. Unless FY 1992's initial general account budget receives heavy supplements, FILP outlays should be above the 50 percent mark at the end of the current fiscal year, as they were in FY 1991 (at 52.1 percent), a first. Over the last several years the rise in the FILP budget consistently has outpaced the growth in the general account budget, a trend that bodes well for fiscal stimulus.

The allocation of FILP monies in FY 1992 differs in many ways from that of FY 1991. Winners for FY 1992 include: social infrastructure other than housing (up 20.1 percent versus 1.7 percent the year before), land conservation (13.1 percent versus 0.6 percent), transportation and communications (51.9 percent versus minus 36.3 percent) and regional development (16.3 percent versus 3.9 percent). Categories suffering lower growth rates include: housing, welfare, education, technology, and foreign economic cooperation. Other categories, such as roads, cash management and small business remain generally about the same. (The fast-growing outlays for "cash management" actually fall into the public works area since much of the money flows into special construction projects.) The growth of each category's annual allocation clearly can fluctuate widely from year to year, perhaps justifying the FILP's reputation as a political pork barrel. The fluctuations also, however, could reflect the uneven demand for funds inherent in FILP's project-specific structure. What can be clearly argued is the second capital budget's growing importance in the government's overall fiscal plan.

Table 4: **Uses and Sources of Japan's Fiscal Investment and Loan Program Outlays (Initial), FY 1988-FY 1992**

(in billions of yen and percent change)

	FY 1988		FY 1989		FY 1990		FY 1991		FY 1992**	
Total Outlays	¥29,614.0	9.4%	¥32,270.5	9.0%	¥34,572.4	7.1%	¥36,805.6	6.5%	¥40,802.2	10.9%
Housing	6,921.5	9.4	7,460.6	7.8	8,365.9	12.1	9,474.5	13.3	9,799.3	3.4
Other Social Infrastructure	4,450.9	11.3	4,371.3	-1.8	4,222.0	-3.4	4,293.3	1.7	5,157.9	20.1
Welfare	661.8	5.4	736.0	11.2	851.9	15.7	1,026.1	20.4	1,109.7	8.1
Education	637.6	-18.7	520.2	-18.4	554.1	6.5	582.4	5.1	582.9	0.1
Small Business	4,030.6	1.1	4,176.4	3.6	4,337.8	3.9	4,494.5	3.6	4,830.1	7.5
Agriculture	979.4	7.9	924.4	-5.6	876.0	-5.2	908.2	3.7	907.9	-0.0
Land Conservation and Disaster Work	409.8	-16.9	357.9	-12.7	328.5	-8.2	330.6	0.6	374.0	13.1
Roads	2,512.1	6.3	2,576.8	2.6	2,700.1	4.8	2,983.2	10.5	3,375.3	13.1
Transportation and Communications	2,229.9	-1.5	2,361.6	5.9	2,304.1	-2.4	1,468.1	-36.3	2,230.4	51.9
Regional Development	652.2	-0.8	676.6	3.7	682.5	0.9	709.0	3.9	824.6	16.3
Industry and Technology	687.2	8.9	758.7	10.4	796.5	5.0	937.7	17.7	965.6	3.0
Foreign Trade and Economic Cooperation	1,171.0	69.6	1,420.0	21.3	1,603.0	12.9	1,898.0	18.4	2,104.5	10.9
Cash Management	4,270.0	27.5	5,930.0	38.9	6,950.0	17.2	7,700.0	10.8	8,540.0	10.9
Total Revenues	¥33,114.0	6.5%	¥34,570.5	4.4%	¥36,572.4	5.8%	¥37,405.6	2.3%	¥41,402.2	10.7%
Industrial Investment Special Account	91.2	-36.8	85.2	-6.6	64.1	-24.8	65.7	2.5	58.1	-11.6
Trust Fund Bureau Fund	26,206.6	6.6	26,871.3	2.5	28,453.3	5.9	29,134.9	2.4	33,489.1	14.9
Postal Savings	7,900.0	0.0	8,500.0	7.6	7,200.0	-15.3	8,800.0	22.2	9,900.0	12.5
Pension Contributions	3,500.0	-21.3	4,310.0	23.1	5,540.0	28.5	6,430.0	16.1	7,230.0	12.4
Other Revenues	14,806.6	20.9	14,061.3	-5.0	15,713.3	11.7	13,904.9	-11.5	16,359.1	17.6
Postal Life Insurance Fund	4,409.4	11.9	5,614.0	27.3	6,055.0	7.9	6,305.0	4.1	6,055.0	-4.0
Government-Guaranteed Bonds and Borrowings	2,406.8	0.3	2,000.0	-16.9	2,000.0	0.0	1,900.0	-5.0	1,800.0	-5.3

Source: Ministry of Finance

An analysis of FILP funding sources reveals some interesting developments. Contributions from the Industrial Investment Special Account, which connects the general account to the FILP budget, appear to have resumed their downward trend after two years of relative stability. It is not clear if MOF intends eventually to sever this link entirely; nor is it clear what advantage this would yield. The role of funds controlled by the postal savings system is expected to continue to be strong in FY 1992 for the second consecutive year. The share of postal savings and life insurance monies in total FILP revenues will be 38.5 percent in FY 1992, down from the previous year's 40.4 percent level. Additions from the government-run pension fund and other government trust monies will continue to provide the majority of FILP revenues in the current fiscal year at 57 percent, only slightly below the recent high mark in FY 1990 of 58.1 percent. As seen from recent years' data, government control of the major sources of FILP funds does not assure stability. MOF's advancing program of financial liberalization will inject profit motives into a system that traditionally has ignored them and likely will force major changes.

MOF's Full Plate Gets More Helpings

Far from being complacent after achieving its goal of eliminating deficit-financing bonds, the Finance Ministry has outlined a long list of fiscal goals and objectives that will occupy its bureaucrats well into the next century. MOF hopes to:

- Reduce total bond issues to less than 5 percent of overall general account revenues by FY 1995.
- Redeem a significant portion of the outstanding national debt (see Tables 5 and 6).
- Restrain the growth of overall government spending to less than the rate of nominal GNP expansion.
- Eliminate budget structures that hide the true size of the deficit and generally make the fiscal blueprint hard to read.
- Improve the government's method of selling its debt. (Deregulation of interest rates has pushed up the average cost of new government bond issues and the refinancing of old ones.)
- Restructure the postal savings system, which eventually must become part of the financial system reform effort.
- Revise government pension and trust funds.

In addition to these self-imposed targets, a host of other objectives is putting, or will put, pressure directly or indirectly on Japanese fiscal policy. As Japan's economy has grown to be the world's second-largest, domestic and foreign leaders have come to expect it to:

- Raise the quality of Japanese life.
- Assist economic development in Third World countries.
- Help resolve the debt crisis of developing countries.
- Aid reconstruction and modernization of Eastern Europe and the former Soviet Union.
- Increase participation in multilateral organizations, such as the International Monetary Fund and the United Nations.
- Help reduce and prevent environmental pollution around the globe.
- Support joint international basic scientific research.

Japanese debate over these goals and objectives is being shaped by current economic and political conditions. The slowing domestic economy coupled with still-weak recoveries in the United States and Germany have generated considerable concern that Japan will experience its first major downturn since the 1973-74 oil crisis. On the political front Tokyo is faced with a rapidly changing global environment in which old rules no longer apply. As far as fiscal policy is concerned, these current economic and political concerns have crystallized into debate over two issues:

Public Works Spending - This issue has both an international and a domestic component. In the 1989-90 Structural Impediments Initiative talks with the United States Tokyo agreed to budget

Table 5: **Japan's Current General Account Budget Deficit, FY 1970-FY 1992**

(in billions of yen and percent of total spending)

Fiscal	Initial Budget								Revised Budget	
Year	Construction Bonds		Deficit Bonds		Total Bonds		Debt Service		Total Bonds	
1970	¥430	5.4%	0	n.a.	¥430	5.4%	¥290.9	3.7%	¥347	4.2%
1971	430	4.6	0	n.a.	430	4.6	319.3	3.4	1,220	12.6
1972	1,950	17.0	0	n.a.	1,950	17.0	455.4	4.0	2,310	19.1
1973	2,340	16.4	0	n.a.	2,340	16.4	704.5	4.9	1,810	11.9
1974	2,160	12.6	0	n.a.	2,160	12.6	862.2	5.0	2,160	11.3
1975	2,000	9.4	0	n.a.	2,000	9.4	1,039.4	4.9	5,480	26.3
1976	3,525	16.0	¥3,750	19.3%	7,275	29.9	1,664.7	6.9	7,375	29.9
1977	4,430	11.9	4,050	17.8	8,480	29.7	2,348.7	8.2	9,985	34.0
1978	6,050	13.6	4,935	18.4	10,985	32.0	3,222.7	9.4	11,285	32.8
1979	7,215	12.5	8,055	27.1	15,270	39.6	4,078.4	10.6	14,050	35.4
1980	6,785	11.5	7,485	22.0	14,270	33.5	5,310.4	12.5	14,270	32.7
1981	6,785	11.8	5,485	14.4	12,270	26.2	6,654.2	14.2	12,900	27.6
1982	6,516	11.5	3,924	9.5	10,440	21.0	7,829.9	15.8	14,345	30.2
1983	6,365	9.9	6,980	16.6	13,345	26.5	8,192.5	16.3	13,486	26.1
1984	6,225	9.8	6,455	15.2	12,680	25.0	9,155.1	18.1	12,781	24.5
1985	5,950	9.4	5,730	12.8	11,680	22.2	10,224.1	19.5	12,308	22.8
1986	5,700	8.9	5,246	11.3	10,946	20.2	11,319.5	20.9	11,495	21.4
1987	5,520	10.2	4,981	9.2	10,501	19.4	11,333.5	20.9	10,539	18.1
1988	5,690	10.0	3,151	5.6	8,841	15.6	11,512.0	20.3	7,967	12.9
1989	5,780	9.6	1,331	2.2	7,111	11.8	11,664.9	19.3	7,111	10.7
1990	5,593	8.4	0	0.0	5,593	8.4	14,449.3	20.7	7,312	10.5
1991	5,348	7.6	0	0.0	5,348	7.6	15,834.3	22.5	6,730	-8.0
1992	7,280	10.1	0	0.0	7,280	10.1	16,447.3	22.8	n.a.	n.a.

Source: Bank of Japan and Ministry of Finance

Table 6: **Japan's Cumulative General Account Budget Deficit, FY 1970-FY 1991**

(in billions of yen and percent of nominal gross national product)

Fiscal Year	Construction Bonds		Deficit Bonds		Refinancing Bonds		Total Bonds	
1970	¥2,642.2	3.5%	¥168.8	0.2%	0.0	0.0	¥2,811.0	3.7%
1971	3,851.1	4.7	100.9	0.1	0.0	0.0	3,952.0	4.8
1972	5,818.5	6.0	0.0	0.0	0.0	0.0	5,818.5	6.0
1973	6,943.5	6.0	0.0	0.0	¥606.8	0.5%	7,550.3	6.5
1974	8,403.6	6.1	0.0	0.0	1,254.8	0.9	9,658.4	7.0
1975	11,178.4	7.3	2,116.9	1.4	1,677.7	1.1	14,973.0	9.8
1976	14,530.1	8.5	5,492.8	3.2	2,053.6	1.2	22,076.5	12.9
1977	19,280.8	10.1	10,253.5	5.4	2,367.9	1.2	31,902.2	16.8
1978	24,964.7	12.0	14,647.2	7.0	3,003.7	1.4	42,615.6	20.4
1979	32,181.7	14.3	21,065.7	9.3	3,003.7	1.3	56,251.1	25.0
1980	38,953.5	15.9	28,257.1	11.5	3,299.1	1.3	70,509.7	28.8
1981	45,149.7	17.4	32,916.3	12.7	4,207.3	1.6	82,273.3	31.7
1982	48,589.4	17.8	40,330.1	14.8	7,562.5	2.8	96,482.0	35.4
1983	51,366.3	18.1	47,059.9	16.6	11,268.4	4.0	109,694.6	38.6
1984	53,447.9	17.6	53,074.5	17.5	15,171.0	5.0	121,693.4	40.2
1985	52,830.3	16.4	57,306.0	17.8	24,295.0	7.6	134,431.3	41.8
1986	52,745.0	15.8	58,846.3	17.6	33,535.2	10.0	145,126.5	43.4
1987	51,923.4	14.8	56,803.0	16.2	43,082.8	12.3	151,809.2	43.2
1988	49,307.3	13.2	54,365.5	14.6	53,107.4	14.3	156,780.3	42.1
1989	48,732.6	12.0	47,825.5	11.8	64,351.8	15.8	160,910.0	39.6
1990	48,065.3	11.0	41,136.6	9.4	77,136.0	17.7	166,337.9	38.1
1991*	47,571.8	10.6	29,253.1	9.8	79,564.2	17.8	166,389.1	37.2
1991**	n.a.	—	n.a.	—	n.a.	—	170,633.7	37.1

*As of end of August 1991. Percent of GNP based on projected FY 1991 nominal growth of 5.2 percent.

**As of end of February 1992. Percent of GNP based on projected FY 1991 nominal growth of 5.2 percent.

Sources: Bank of Japan and Ministry of Finance

¥430 trillion ($3.2 trillion) for public works spending over the next decade, a figure calculated to boost the ratio of public works outlays to projected GNP to over 7 percent (see *JEI Report* No. 26B, July 6, 1990). This would be sharply higher than the ¥274 trillion ($2 trillion-plus) spent during the FY 1981-FY 1990 period. To achieve the new goal public works spending will have to grow about 6.1 percent annually. While FY 1992 spending projections easily surpass this mark, there is no guarantee that the pace of spending will remain high. If Japan does not commit the pledged amount, the shortfall, by itself, is unlikely to become a major bilateral irritant, but it could add fuel to other simmering issues.

Domestically, Prime Minister Kiichi Miyazawa has pledged to make Japan a consumer superpower and, more recently, has promised to spur domestic growth through higher government spending. Given the priorities outlined in the FY 1992 general account budget, public works projects clearly are key to this objective. There is growing concern, however, that boosting public works spending may not be effective. If significant purchases of expensive land are part of the public works plan, much of the higher spending may be committed in ways that do not create new demand for goods and services. (In fact, such expenditures could reignite real estate speculation in areas where new projects are located, a distinctly undesirable result.) Another concern is inflation, since Tokyo's last sharp spur to public works spending in the late 1980s resulted in higher inflation in the construction and building materials industries. Furthermore, critics point out that Japanese construction companies cannot now take on more business; their order books already are backed up as much as a year.

Global Responsibility Fund - The difficulties Tokyo faced raising funds for Japan's contribution to defray the allies' costs of the Persian Gulf crisis demonstrated to government leaders there the need for a pool of money for emergencies. If Japan truly is to accept greater international responsibilities, the money to act must be available at a moment's notice, some government officials have argued. In the fall of 1991 the ruling Liberal Democratic Party and the government floated several ideas to impose a tax specifically for a "global responsibility" fund. The idea of a special tax on fossil fuels to fund environmental programs also has been raised. Public reaction to both proposals was swift and negative. Nevertheless, MOF has earmarked as available for special projects revenues from a new land-holding tax and a special surcharge on corporate income taxes.

Conclusion

The Finance Ministry's budget duties were lightened considerably in the late 1980s by an expanding revenue pie that allowed the apportioning of funds to a growing number of projects at the same time that existing ones fared better, too. Since FY 1990, however, the revenue pie has grown much less rapidly, while demand for new spending has continued to expand apace. Further complicating MOF's current fiscal planning are forces beyond its control, such as foreign pressure, financial market restructuring and unpredictable equity markets. Perhaps the biggest threat to MOF's fiscal austerity tenet in FY 1992 will be the dragging economy. The slowdown, which appears to have surprised everyone with its rapid onset and steep descent, has increased geometrically the pressure for bigger public works spending. The government's FY 1992 spending plan already has forced MOF to accept an increase in construction bond outlays. If the slowdown becomes a deep recession, it could endanger MOF's self-imposed ban on new deficit-financing bonds. The clamor for government stimulation aside, the expected tax revenue shortages are sure to pressure MOF's existing budgets just as effectively. The flexibility and ingenuity — as well as resolve — of MOF budget planners will be sorely tested in the coming years.

For further information, contact **Jon Choy**.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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JAPAN · ECONOMIC · INSTITUTE

JEI REPORT

A Two-Part Report: A and B

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Japan's Trade Surplus Sets Record In First Quarter

Japan's trade surplus on a customs-clearance basis soared 73 percent in the first quarter of 1992 to $25 billion, the highest quarterly level in Japanese history (see Tables). For most policymakers in Tokyo the news was perhaps more devastating than it was to those in Washington. Japanese officials fear that the rising global imbalance will fan the flames of protectionist sentiment in the United States and elsewhere. For their part some American officials may take the latest figures to mean that the stated Japanese objective of trying to reduce its huge aggregate trade surplus has not been sincere.

Both sides, however, might agree that Japan's expanding trade imbalance raises difficult questions of international macroeconomic policy coordination — especially when put in the context of developments since early 1991, a year in which trade imbalances were heavily influenced by the fact that Japan and its trading partners were in different phases of the business cycle. In the first half of last year Japan's exports to the United States were flat at best, while imports from this country dropped in yen terms but rose in dollars compared to the same period a year earlier. As a result, the bilateral surplus declined by both the dollar and the yen measure. These trends reflected the fact that

Table 1: **Japan's Total Trade in Dollar Terms**

(in millions of dollars)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1987		$229,221	9.6%	$149,515	18.3%	$79,706
1988		264,917	15.6	187,354	25.3	77,563
1989		275,175	3.9	210,847	12.5	64,328
1990		286,948	4.3	234,799	11.4	52,149
1991		314,526	9.6	236,737	0.8	77,789
1990:	I	66,705	-2.2	54,383	6.3	12,322
	II	67,232	-0.5	53,954	5.2	13,278
	III	72,189	3.7	56,547	6.6	15,642
	IV	80,822	15.9	69,914	26.3	10,908
1991:	I	76,338	14.4	61,869	13.8	14,469
	II	73,992	10.1	56,283	4.3	17,709
	III	79,065	9.5	57,097	1.0	21,968
	IV	85,131	5.3	61,487	-12.1	23,644
1992:	I (p)	82,388	7.9	57,356	-7.3	25,032

Table 2: **Japan's Total Trade in Yen Terms**

(in billions of yen)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1987		¥33,315	-5.6%	¥21,737	0.9%	¥11,578
1988		33,939	1.9	24,006	10.4	9,933
1989		37,823	11.4	28,979	20.7	8,844
1990		41,457	9.6	33,855	16.8	7,602
1991		42,360	2.2	31,900	-5.8	10,460
1990:	I	9,766	12.2	7,941	21.9	1,825
	II	10,449	13.3	8,392	19.9	2,057
	III	10,651	7.5	8,364	10.8	2,287
	IV	10,592	6.1	9,159	15.7	1,433
1991:	I	10,183	4.3	8,257	4.0	1,926
	II	10,225	-2.1	7,775	-7.4	2,450
	III	10,853	1.9	7,846	-6.2	3,007
	IV	11,097	4.8	7,998	-12.7	3,099
1992:	I (p)	10,513	3.2	7,303	-11.6	3,210

Table 3: **Japan's Trade with the United States in Dollar Terms**

(in millions of dollars)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1987		$83,580	3.9%	$31,491	8.4%	$52,090
1988		89,634	7.2	42,037	33.5	47,597
1989		93,189	4.0	48,246	14.8	44,943
1990		90,322	-3.1	52,369	8.5	37,954
1991		91,538	1.3	53,317	1.8	38,220
1990:	I	21,661	-4.7	12,753	9.9	8,908
	II	20,938	-9.0	12,861	6.6	8,077
	III	22,933	-4.9	12,729	2.1	10,204
	IV	24,790	6.2	14,025	15.7	10,765
1991:	I	22,311	3.0	13,268	4.0	9,043
	II	20,304	-3.0	13,464	4.7	6,840
	III	23,719	3.4	13,185	3.6	10,534
	IV	25,205	1.7	13,401	-4.4	11,804
1992:	I (p)	22,746	1.9	13,458	1.4	9,288

Table 4: **Japan's Trade with the United States in Yen Terms**

(in billions of yen)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1987		¥12,148	-10.4%	¥4,582	-6.8%	¥7,566
1988		11,487	-5.4	5,388	17.6	6,099
1989		12,816	11.6	6,632	23.1	6,184
1990		13,057	1.9	7,586	14.4	5,471
1991		12,324	-5.6	7,191	-5.2	5,133
1990:	I	3,171	9.4	1,862	26.0	1,309
	II	3,254	3.7	2,000	21.4	1,254
	III	3,384	-1.5	1,885	6.3	1,498
	IV	3,249	-2.8	1,838	6.1	1,411
1991:	I	2,977	-6.1	1,770	-4.9	1,207
	II	2,806	-13.8	1,860	-7.0	946
	III	3,255	-3.8	1,812	-3.9	1,443
	IV	3,287	1.2	1,749	-4.8	1,538
1992:	I (p)	2,902	-2.5	1,717	-3.0	1,185

Japan's economy was still expanding, while the United States was in the grip of a recession. However, dollar-denominated shipments to this country were up a modest 1.9 percent during the January-March 1992 quarter, possibly reflecting rising demand in this country. At the same time Japanese imports from the United States managed a slight 1.4 percent gain as measured in dollars, leaving the dollar-denominated bilateral surplus 2.7 percent larger than a year ago, although the yen-denominated bilateral surplus showed a decline of 1.8 percent.

On a worldwide basis Japanese imports were down a sharp 7.3 percent in dollar terms in the first quarter from a year earlier, reflecting the slowdown in the Japanese economy. Exports were up 7.9 percent. In short, given the linkage between overall economic growth and rising imports, the numbers suggest that Japan's trading partners, including the United States, were in the midst of a modest recovery, while the domestic economy still was deteriorating in the January-March period. A relatively strong overall U.S. export performance has received partial credit for the still-fragile economic recovery in this country. However, the continued weakness in the Japanese economy suggests that the role played by America's second-largest trading partner in the U.S. rebound has been, and is likely to remain, small.

Japan's apparently minimal effect on the performance of the American and European Community economies is unlikely to dissuade officials in Washington and Brussels from pressing their trade demands in Tokyo. Neither American nor European policymakers are likely to stand by idly while, in their view, Japan exports its recession to its trading partners by means of smaller imports and larger exports. The Bush administration already has served notice that the state of the Japanese economy is likely to be high on the agenda at the April 26 meeting in Washington of finance ministers and central bankers from the Group of Seven industrial nations. Japan's G-7 partners are likely to press Tokyo to take a more activist approach toward stimulating the economy. The measures announced to date — consisting primarily of a program of accelerated (but not increased) public works spending and a 0.75 percentage point cut in the discount rate — are seen outside Japan as insufficient. (For details of these programs, see *JEI Reports* No. 12B, March 27, 1992, and No. 14B, April 10, 1992.) Many Japanese analysts agree that an expanded stimulative program is likely before the end of the year if the economy does not show signs of improvement. However, even the recently announced initiatives are likely to take at least a few months to stimulate domestic demand enough to draw in more imports; any supplemental program would take still longer. Analysts on both sides of the Pacific are bracing themselves for additional Japanese black ink on the trade front in the coming months.

Douglas Ostrom

Miyazawa Diplomacy To Focus On Northern Territories, Aid To Russia

After more than three decades of hitting a brick wall in direct discussions with Moscow concerning Japan's claims to four Russian-occupied islands north of Hokkaido, Tokyo has decided to turn once more to indirect international suasion to affect progress on this dispute. During an April 28 to May 2 diplomatic swing through France and Germany Prime Minister Kiichi Miyazawa plans to lobby Paris and Bonn to agree to consideration of the so-called Northern Territories dispute at the early July meeting in Munich, Germany of the leaders of the Group of Seven major industrialized democracies. Finance Minister Tsutomu Hata no doubt will pursue a similar strategy when he meets with his G-7 counterparts in Washington at the end of April prior to the semiannual conferences of the International Monetary Fund and the World Bank. Some Japanese political commentators have remarked that G-7 acknowledgement of Japan's territorial claim could give Mr. Miyazawa the upper hand when he meets with Russian President Boris Yeltsin in September to discuss the Northern Territories and other bilateral issues.

This is not the first time Tokyo has put the legitimacy of its territorial claim with the former Soviet Union before the G-7. At last year's summit meeting the Japanese government secured indirect support from the heads of government of the six other participating countries (see *JEI Report* No. 28B, R-5650-2

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JEI

REPORT

A Two-Part Report: A and B

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JAPAN'S SLEEPING INSURANCE GIANTS: ROUSED AND READY?

SUMMARY

Japanese insurance companies are international financial giants but largely overlooked, especially outside Japan. They have served as a destination for a portion of Japan's large pool of savings and as a factor in capital markets, roles that in recent years have increased substantially and had spillover effects on foreign markets.

Competition is minimal in the Japanese insurance industry, which arguably enhances the importance of keiretsu, *Japan's large corporate groups, in the distribution of insurance products. New insurance products and regulatory changes have increased the amount of competition in the market, however.*

For various reasons American and other foreign insurance companies play a small role in the Japanese market. The industry's unusual structure, great size and minimal foreign market share have attracted the attention of American and other foreign trade negotiators, but the prospects for an early international agreement that would cover insurance and other financial services are uncertain at best.

The Japanese Insurance Industry in an International Context

In many respects insurance is the Rodney Dangerfield of industries: it doesn't get any respect. While most households and firms are users of insurance products in the United States and Japan, few people in either country know much about the companies from which they are buying the product. Yet, the industry is a giant in both countries. In the United States employment was an estimated 536,000 in 1991, twice the size of the automotive manufacturing industry and two-thirds the size of the automotive parts industry. In Japan the industry employed 699,000 people in firms of five or more employees as of December 31, 1990, the most recent year for which data are available. That figure was roughly two-thirds the number in automotive and automotive parts manufacturing and also comprised a substantially larger number relative to national population than in the United States. Despite these numbers, Maurice Greenberg, the chairman of the U.S.-based insurer doing the most business in Japan — American International Insurance Group, Inc., got far fewer headlines as a result of accompanying President Bush to Japan in January than did the chief executives of the Big Three automotive makers.

One reason insurance companies get little publicity is their ownership structure. Stock market guides and business magazines say little about them because many Japanese and American insurance companies have no stockholders; instead, these insurers are mutual companies technically controlled by their policyholders. Most households might well be amazed to realize that by buying insurance policies from companies like Nippon Life Insurance Co. and State Farm Insurance Co. they gain the right to participate in corporate decisionmaking. This right rarely is exercised in either the United States or Japan, however.

In addition, industries in both countries keep low profiles in other ways. Befitting its status as a neglected giant of the financial world, State Farm, despite having nearly twice the capital of Merrill Lynch & Co., has its corporate headquarters in Bloomington, Illinois, far from the madding Wall Street crowd and some distance even from LaSalle Street, Chicago's counterpart to Wall Street. Nippon Life, the world's largest insurance company as measured by assets, traditionally has had its home office in Osaka, Japan's version of a "second city," although it now has headquarters in Tokyo as well.

Law and tradition divide the insurance industry in Japan into life and nonlife insurance. Life insurance companies sell products that are varying combinations of long-term savings vehicles and term insurance against a policyholder's death or serious illness. Nonlife insurance companies, which engage in a narrower range of businesses than their property and casualty American counterparts, insure against losses from automobile accidents, fire and other misfortunes. Japanese writers sometimes simplify the identification by saying that life insurance companies insure people and nonlife companies insure things. Each type of insurance company in Japan is prohibited from entering the other business. Both types offer insurance policies to individuals as well as corporations.

Although Japan has a significantly smaller population or gross national product than the United States, its life insurance market is larger. In 1989, the latest year for which comparable data are available, premiums equaled $199 billion in Japan versus $188 billion in the United States, the world's second-largest market. In contrast, nonlife insurance was much larger in this country at $265 billion against $66 billion in Japan, where insurers nosed out their West German counterparts for second place. To a significant extent Japan's enormous life insurance market reflects the use of life insurance as a savings vehicle. In fact, as will be explained below, even nonlife insurance companies in Japan have developed ways of competing for the nation's large pool of savings.

Table 1 shows the significant role that Japanese insurance companies play in the Japanese economy as measured by total operating funds. While commercial banks collectively are far bigger, life insurance companies are fewer in number, with the result that assets per institution are larger at life companies. As a group nonlife insurance companies have a far smaller role as holders of assets, but per institution they still are relatively large in this regard. Table 1 also shows several clear trends. In the early postwar years insurance companies played a more limited role than they did in 1934 and banks had a larger one. Since at least the 1970s, however, both types of insurance companies have been gaining ground vis-a-vis banks to the point that in 1990 insurers had a larger share of total operating funds than in 1934 while the bank share had declined sharply. Two government-related institutions — the savings portion of the Trust Fund Bureau (in effect, the postal savings system) and the postal life insurance (*Kampo*) and pension systems — also have gained ground on banks in terms of operating funds since the 1970s. The relative importance of the Trust Fund Bureau, however, has

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Table 1: **Role of Banks, Insurance Companies and Other Financial Institutions in Japan's Financial Markets, 1934-90**

(percentages of total operating funds in all financial sectors)

	All Banks	Shinkin	Shoko Chukin	Norinchukin	Agricultural Cooperatives	Insurance Companies			Trust Fund Bureau	Postal Funds	Other
						Life	Nonlife	Total			
1934	63.9%	0.8%	0.0%	0.8%	5.0%	9.0%	1.9%	10.9%	14.7%	3.8%	0.0%
1955	65.1	4.0	0.8	2.2	5.3	2.4	1.1	3.5	11.6	3.3	4.2
1960	65.2	5.0	0.9	1.5	4.4	3.7	0.9	4.6	10.3	3.7	4.3
1965	61.4	6.4	1.0	2.6	5.0	4.3	0.8	5.1	9.7	2.5	6.3
1970	55.2	7.2	1.1	2.1	5.7	5.1	1.0	6.2	12.7	2.2	7.5
1975	52.3	7.4	1.3	2.0	5.9	4.6	1.2	5.8	15.3	2.4	7.7
1980	47.6	6.9	1.1	2.2	5.5	5.0	1.2	6.2	19.4	2.9	8.1
1985	45.2	6.3	1.1	2.3	5.0	6.3	1.3	7.6	20.4	3.5	8.6
1986	44.8	6.1	1.1	2.6	4.7	6.9	1.4	8.3	20.1	3.5	8.7
1987	45.4	6.0	1.1	2.5	4.5	7.4	1.6	9.0	19.5	3.6	8.5
1988	45.1	6.0	1.0	2.4	4.3	8.3	1.7	9.9	19.1	3.6	8.5
1989	45.6	6.1	1.0	2.1	4.2	8.9	1.7	10.6	18.6	3.7	8.1
1990	45.7	6.2	1.0	1.8	4.3	9.4	1.8	11.2	18.0	3.8	8.0

Note: *Shinkin* are credit associations.
Shoko Chukin - Central Bank for Commercial and Industrial Cooperatives
Norinchukin - Central Cooperative Bank for Agriculture and Forestry
Postal funds cover the Postal Life Insurance (*Kampo*) and Postal Annuity systems.

Source: Compiled from data in Ministry of Finance, *Hoken Nenkan (The Insurance Yearbook)* (Tokyo: Okura Zaimu Kyokai, 1991), p. 771.

declined since 1985, a development arguably reflecting the relatively slow growth of the government organizations financed by the trust fund.

Insurance Companies as Investors

The figures on insurance premiums suggest that insurance companies' policies, and often their salespeople as well, are to be found in virtually every home. In addition, insurance companies loom large in national financial markets as investors of funds. The essence of life insurers' business is to collect premiums, invest them and then return them to the policyholder in the event of premature death or at the policy's maturity. Because the interval between the payment of premiums and that of benefits may be decades, life insurance companies have the reputation in Japan, as they do in the United States, of being very long-term investors. As will be discussed further below, this gives them a valuable role in Japanese stock markets, where their patience is appreciated.

In the late 1980s financial institutions as a group held about 46 percent of the stock outstanding on Japanese stock exchanges. Of this, life insurance companies held about 20 percent of the total, and nonlife insurance companies another 3 percent. Japan's 12 nationwide commercial banks, known as city banks, held more stock per company than the 26 life insurance companies; moreover, holdings by all 154 Japanese banks were greater than those of life insurers. Nevertheless, life insurance company holdings were larger per institution than for the banking industry. Number-one Nippon Life was reported to account for about 3 percent of all stock-holding by itself.

Under the government's financial liberalization actions in the 1980s Japanese insurance companies were major beneficiaries with respect to their investment activities. One move significantly lifted caps on how much of the insurance companies' security portfolios could be allocated to foreign securities. For example, in August 1986 the Ministry of Finance permitted insurance companies to hold as much as 30 percent of their assets in foreign currencies. Insurance companies responded by increasing their overseas portfolios dramatically (see Table 2). Foreign securities grew from less than 0.05 percent of total assets in March 1973 to 13 percent in March 1991.

Table 2: **Composition of Assets of Japan's Insurance Industry, 1973-91**

(in billions of yen)

March 31	Foreign Securities	Total Assets	Foreign Securities as Percent of: Assets	Foreign Securities as Percent of: Securities
1973	¥3	¥8,181	+0.0%	0.2%
1975	6	11,111	+0.0	0.2
1980	524	22,744	2.3	7.4
1981	669	26,258	2.5	8.4
1982	1,413	30,099	4.7	14.6
1983	2,169	34,614	6.3	19.2
1984	3,063	39,527	7.7	22.4
1985	4,029	45,740	8.9	25.1
1986	4,668	53,871	8.7	24.5
1987	7,525	65,317	11.5	28.1
1988	9,803	79,258	12.4	21.5
1989	13,596	97,083	14.0	30.4
1990	17,790	116,160	15.3	32.5
1991	16,985	130,251	13.0	29.4

Source: Ministry of Finance, *Hoken Nenkan (The Insurance Yearbook)* (Tokyo: Okura Zaimu Kyokai, 1991), pp. 754 and 756.

As values on the Tokyo Stock Exchange have plummeted this year Japanese insurance companies have attracted attention as a result of their important role as holders of stock. As will be shown below, they typically have held large shares of stock in other companies as a way of cementing business ties and directing those firms' business in their direction. Some analysts have worried, however, that the weakness of the Tokyo stock market may force insurers to sell a significant portion of their shares. Others have expressed the hope that insurance companies would buy more shares in an effort to buoy the market. However, Kenjiro Hata, chairman of Meiji Mutual Life Insurance Co. and head of Japan's life insurance trade association, appeared to disabuse both kinds of speculation at an early April news conference. He said, for example, that insurers would not request the government to raise current ceilings regarding securities holdings as a percentage of assets. He added that insurance companies would continue buying equities. Insurers admit, however, that they are adding less to their stock portfolios than they otherwise might.

Americans are particularly interested in Japanese life insurance companies' investments in this country. In the past 10 years these firms drew attention by purchasing both U.S. securities and real estate, with the latter often large city-center buildings, frequently called "trophy" properties. For example, Dai-Ichi Mutual Life Insurance Co. holds equity investments in Citicorp's two headquarters office buildings in New York City.

As the Japanese economy began to grow more slowly in 1991 and 1992 the growth rate of insurers' overseas assets also slowed, although total assets continued to increase. Japanese life insurance companies still provide little detail about their offshore activities, but they are somewhat more forthcoming than in the past. For example, Dai-Ichi's foreign equity holdings totaled ¥734 billion ($5.4 billion at ¥135=$1.00) as of March 31, 1991, up 12.2 percent from the year before. Its bond holdings, however, dropped 4.3 percent to ¥1.4 trillion ($10.4 billion). Overall, foreign investments increased 3.7 percent. This result suggests that, despite the concurrent weakness in the Japanese stock market, Dai-Ichi did not liquidate its overseas holdings. On the reasonable assumption that Dai-Ichi is typical, given the parallel actions that generally characterize Japanese life insurance companies, these figures suggest that the much-feared Japanese insurance company pull-out from foreign markets did not occur over that period.

Life insurance companies also have been called on to help bail out Japan's commercial banks since the Japanese stock market began declining in 1990. Like insurance companies, banks have seen their paper profits from stock investments decline sharply. Banks in Japan had been counting on using as much as 45 percent of these profits as capital to meet Bank for International Settlement requirements that they have capital equal to 8 percent of assets by March 31, 1993. As this means of achieving the goal has disappeared, banks have turned to the insurance companies for subordinated loans, another source of capital. Such loans are considered virtually the equivalent of equity since interest is paid only after other debt obligations are met. As a result, insurance companies typically demand a high interest rate. How life insurers will weigh the risk/return trade-off regarding subordinated loans remains to be seen, especially in light of their own weakened balance sheets and Ministry of Finance preliminary moves to tighten minimum capital standards for insurers themselves (see *JEI Report* No. 8A, February 28, 1992).

The Insurance Industry in Japan

Investments are possible, of course, only if insurers sell policies. In Japan as here many employees have life insurance through plans set up by their employers; other individuals purchase insurance from the thousands of door-to-door saleswomen employed by insurance concerns. Nonlife insurance companies provide many kinds of insurance to firms, such as hull insurance targeted toward shipping companies. Traditionally, business insurance was the most important product line for nonlife companies, but in the postwar period increasing amounts of insurance have been sold to individuals, especially the type of nonlife insurance that now represents the largest premium value — automobile insurance.

Rates for insurance in Japan are not necessarily set by market forces; sometimes they are determined through cooperative arrangements. For life insurance, administrative guidance from the Ministry of Finance traditionally has meant that rates vary little among insurers and that even the weakest companies survive. (This concept sometimes is called the "convoy approach.") One study has suggested that, at least for some kinds of life insurance, the Japanese industry is much more profitable than its U.S. counterpart. For example, the rate of return on a nonparticipating whole life product is said to be 8 percentage points higher in Japan than in this country.[1]

Nonlife insurance firms are required to belong to rating associations that fix rates for automobile and fire insurance; marine rates also are set cooperatively. The result is that Japanese nonlife companies typically have made profits, not just from their investments but from their underwriting activity as well; this situation puts them in an enviable position vis-a-vis their American counterparts. (The fiscal year that ended March 31, 1991 proved an exception, however, as most companies and the industry as a whole lost money on an underwriting basis.)

While the situation of the nonlife and life insurance industries would appear similar with respect to pricing, in fact it differs substantially. As joint stock companies nonlife firms presumably pay any extra profits from their cartel-like arrangement to stockholders, either directly in terms of higher dividends or indirectly in the form of a higher stock price. The market mechanism also works to monitor the companies' behavior. Better-managed companies will have a better stock performance, sending a signal concerning poorly managed companies to financial markets, policyholders and perhaps managements themselves.

Life insurance companies, which are mutual companies for the most part, typically have no stockholders. What then happens to any extra profits? Ryutaro Komiya, formerly of the University of Tokyo and now at Aoyama Gakuin University, suggests that employees and policyholders share the spoils.[2] Each year virtually every life insurance company pays its policyholders dividends that are based, in part, on the company's profit; these dividends average approximately 10 percent of annual insurance premiums, with some companies paying as much as 15 percent and others paying nothing. In addition, long-term policyholders typically get far more than short-term policyholders, although the actual formulas are very complicated. Moreover, firms that have a record of good management attract better employees since wages are higher. Hence, policyholders in better-run companies benefit directly from higher dividends and indirectly from more skilled employees.

One portion of dividends is called special dividends. Paid to long-term policyholders, these payments are among the few that the Ministry of Finance permits to be paid out of capital gains as opposed to current income. As long as the Japanese stock market rose regularly every year, companies easily could afford this obligation and tended to pay the same rate. However, as the stock market has declined in Japan, accumulated capital gains have diminished. Between September 1989 — when the market was close to its peak — and March 31, 1992 accumulated paper profits plunged from ¥47 trillion ($348 billion) to ¥10 trillion ($74 billion). They declined unevenly, however. Those insurance companies that grew more rapidly in the bull market of the late 1980s bought equities at higher average prices than companies that grew more slowly. Most observers speculate that small and medium-sized insurers have seen the sharpest declines in their paper profits, with a couple of Japan's 26 life insurance companies now having paper losses. In some contrast, the largest life insurance company, Nippon Life, saw its hidden profits decline from ¥11.2 trillion ($83 billion) to ¥3 trillion ($22 billion) over the same period, a somewhat smaller-than-average drop.

As a result of these differential changes in accumulated gains, Mr. Hata, the head of the life insurance trade association, admitted at his April news conference that a gap could open on special dividend rates. Other observers have speculated that industry reorganization could follow if the weakness of the stock market continues over the coming months and years.

These arguments suggest that MOF's efforts to standardize life insurance products and prices have not been entirely successful. However, policyholders have difficulty voting with their feet.

Since long-term policyholders are rewarded with larger dividends, switching is costly. In addition, the complexity of policies and the web of rules for dividend distribution aggravate determination of whether or not one is getting a generous dividend compared to one's neighbor or relative. In short, administrative guidance may not have eliminated those differences to which policyholders attach potential importance in choosing an insurer; however, policyholders have great difficulty obtaining relevant information or acting on it if they do obtain this input.

New Insurance Products and Trends

Like financial services industries elsewhere, the Japanese insurance industry has introduced a plethora of new products and services in recent years. Three broad types of products may be distinguished.

Savings Vehicles - Japanese life insurance companies, faced with mature markets for their traditional term and whole life products, have invaded areas that the banking industry regards as its turf. The battle among these titans is for the huge pool of Japanese savings. Smaller life insurance companies, such as Daido Mutual Insurance Co. and Chiyoda Mutual Life Insurance Co., for years have offered a type of highly liquid pension plan known as *kyosai nenkin* to employers terminating their in-house savings programs. Until 1989 the biggest insurers held back, reportedly reluctant to offend the largest banks, which regarded such programs as directly competitive. That year, however, large insurers, such as Nippon Life, entered the market in response to the rising share of savings attracted by these relatively small insurers.

Banks faced additional, substantial competition from another life insurance product. Single-premium endowment insurance, which comes with a fixed term, had attractive interest rates during the low interest rate era between 1987 and 1989, thereby attracting savings that otherwise probably would have gone to banks. In effect, this insurance policy was directly competitive with banks' long-term certificates of deposit; when interest rates on those bank products rose after 1989, insurance companies' business in savings-type products dropped sharply. In response, life insurers introduced single-premium variable endowment insurance in late 1990. This product, in which the yield depends on the investment performance of a portfolio of stocks and bonds, takes direct aim at the core business of brokerage firms. Securities companies howled, but their best defense, of sorts, has turned out to be the weak stock market, which has kept yields — and interest in the product — quite low.

Even nonlife companies have gotten into the chase for the unconsumed yen. In connection with fire insurance or accident insurance, for example, policyholders can opt to have what is called maturity-refund insurance. Under this program the insured takes out a policy for a fixed term of at least several years and gets savings plus interest on a portion of the premium payments. Approximately 10 percent usually goes toward the insurance, with the remainder allotted to the savings program. Like life insurers' fixed interest rate products, the maturity-refund programs boomed in the low interest rate era but have floundered as interest rates have risen since 1989.

In addition to trying to beat banks and brokerage firms for savers' deposits, insurance companies at times have joined with their competitors in introducing hybrid products. For example, as of January 1990 Meiji Mutual Life and Industrial Bank of Japan, Ltd. began offering a combination pension and interest-bearing bond product; the pension premiums were to be paid with interest from the bond. In addition, the product gave the policyholder comparatively easy emergency access to his or her funds.

Niche Products - As competition has increased in the insurance industry, companies increasingly have introduced products that, while not really substantively new, appeal to policyholders in special groups. Among the best-known of these is a nonlife product known as hole-in-one insurance. The policy pays off not as some sort of consolation prize for bad to middling golfers but to those on whom fortune smiles. By tradition in Japan those golfers who achieve a hole in one incur huge expenses treating their companions; the insurance is to cover those costs. For the truly unlucky golfer nonlife firms offer insurance against being hit by errant balls. Another new niche product is insurance covering relatively short periods of time. For example, companies now offer insurance against a variety of accidents that could occur on a specific weekend trip.

Products and Services for the Elderly or Those Who Will Be - Japan's consciousness that the population is aging is progressing even faster than the actual process. Capitalizing on this new awareness, both life and nonlife insurance companies are marketing new products, not just to those who are already old but to people who may feel that they will have few family- or government-provided resources in their old age, which may be decades away.

Cancer insurance offered by American Family Life Assurance Co., a firm based in Columbus, Georgia, is one example of this kind of product. In the late 1980s both life and nonlife companies responded to increased fears about senility by offering dementia insurance; the insurance arm of the agriculture cooperative federation, *Zenkyoren*, has marketed a similar policy. The life insurance variant provides income in case of this disease; the nonlife version covers payments relating to treatment expenses.

Another product targets women. Given the fact that women typically are younger than their husbands in Japan and live to an older age, wives there (as in the United States) may expect many years of widowhood. One niche product is designed to supplement what many women apparently feel will be inadequate pensions after the death of a husband. Sales of such policies increased 40 percent last year compared to 1990.

In recent years companies have taken concern with the elderly a step further. This spring Nippon Life plans to open a 362-bed retirement home. (For details of aging and Japan's long-term care, see *JEI Report* No. 14A, April 10, 1992.) Nonlife insurance companies have moved recently to establish new subsidiaries that eventually may supply in-home nursing care and other medical needs. Their main initial purpose will be to provide medical advice and referrals by phone, although social workers in some instances will come to the home.

A potentially promising new area involves product liability insurance against lawsuits that a manufacturer or other firm may face. Japanese nonlife insurance firms are reacting with a combination of anticipation and dread to the possibility that Japan will enact legislation making such suits easier. They welcome the new business, of course, but look with horror at the many examples involving American companies. A recent example concerns Dow Corning Corp. and its insurers, which may face multimillion-dollar liabilities as a result of lawsuits concerning silicone-gel breast implants.

A few patterns stand out from this discussion of new products. Insurance companies are attempting to stake out claims to provide services that arguably are the natural domain of either banks or securities companies. In addition, life and nonlife insurance companies, whose businesses by law and tradition have been mutually exclusive, are competing with each other in an increasing number of areas. Both these trends suggest that the lines dividing industries are becoming increasingly blurred, a pattern that also has been observed in the United States. If anything, this development has taken longer to emerge in Japan than in this country. In a few instances U.S. companies, such as Equitable Life Assurance Co. of the United States and AFLAC, were able to tap their expertise in developing products for the American market in launching products in Japan, although, as will be shown below, U.S. companies have gained little in terms of market share as a result of these innovations.

Another pattern is increased competition. For insurers to be successful on bankers' turf, they have to offer superior products on favorable terms. The Ministry of Finance, which supervises both banks and insurance companies, cannot be expected to provide blanket protection to insurers in this situation. Further, many of the new products have yields tied to market performance and to fund management skills. As these abilities inevitably differ among insurance companies, so, too, will yields. Hence, the insurance industry's cartel-like arrangement faces erosion, particularly with respect to life insurers.

As noted above, American insurance companies, banks and brokerage houses have been down this path already. Not too surprisingly, they have found it perilous in this country. As yields become more important to customers, both banks and insurance companies sometimes have been tempted to offer more than they can afford, resulting in problems. In particular, American investors in so-called guaranteed investment contracts have lost millions in forgone income when a few of the insurance companies that offered GICs were unable to pay the guaranteed rate.

Few observers believe that Japanese companies are in nearly so serious a situation. For one thing, many of their policies are still priced in a noncompetitive manner. However, recent rare losses by nonlife insurers on their underwriting business may be a shot across the bow, even though at the time the losses easily were offset by their investment business. Yet, for all the problems — real or prospective — of Japan's insurers, the Japanese insurance market rests securely in the world's number-two spot and is a tempting prize for entrants from other industries and for insurance companies based outside Japan.

Other Insurance Organizations in Japan

Alongside private life and nonlife insurance companies in Japan exists a variety of other insurance entities, typically parts of larger governmental or cooperative organizations. Some of these insurers are very large. For example, *Kampo*, the life insurance arm of the postal savings system, has more assets under its management than the combined assets of the top two private life insurance companies. Bureaucratically, *Kampo* is under the wing of the Ministry of Posts and Telecommunications rather than the Ministry of Finance, the regulator of life insurers. Between 1978 and 1988, the most recent year for which comparable data are available, *Kampo* policies in force increased by a factor of 1.8, almost identical to the 1.7-fold increase registered by private insurers; this suggests that *Kampo*'s share of the insurance market has been roughly constant.

Other important participants in the insurance market are the insurance arms of agricultural cooperatives; their nationwide organization is *Zenkyoren* (National Insurance Federation of Agricultural Cooperatives). *Zenkyoren* is involved in both life and nonlife insurance, with nonlife insurance being about three times larger. It is bigger than all but Nippon Life among Japanese insurance companies, making it one of the world's five largest insurers by some measures. Between 1979 and 1988, the most recent year for which data are available, *Zenkyoren* contracts outstanding grew 11.7 percent a year, faster than the 10 percent annual rate registered by life insurance companies or the 8.6 percent growth recorded by nonlife companies.

Until recently *Kampo* followed conservative investment philosophies, limiting the returns possible on savings-type products. In addition, the proportion of the population living in rural areas, *Kenkyoren*'s stronghold, has been declining. The ability of these two organizations to hold their own — and then some — in competition with private companies may reflect on the continued lack of competition among private insurers.

Foreign Insurance Companies in Japan

Foreign insurance companies have a long, if generally unremarkable, history in Japan. Both foreign life and nonlife companies date from the 1940s. American firms predominate among both types of companies (see Tables 3 and 4). American International Group's Japanese life insurance subsidiary, American Life Insurance Co., reigned as the biggest foreign life insurer until 1989. In that year AFLAC, which, as noted above, has carved out a niche in cancer insurance, became the largest foreign firm and the 18th largest among the 40 firms that sell life insurance in Japan. However, despite having 9 million policies outstanding, AFLAC's share of the total market is less than 1

Table 3: **Foreign Life Insurance Companies Operating in Japan***

Company	Year Licensed
American Companies	
Pioneer American Insurance Co.	1952
World Service Life Insurance Co. of Colorado	1953
American Life Insurance Co.	1954
Transamerica Occidental Life Insurance Co.	1955
American Amicable Life Insurance Co.	1957
Midland National Life Insurance Co.	1964
United of Omaha Life Insurance Co.	1964
American Defender Life Insurance Co., U.S.A.	1973
American Fidelity Life Insurance Co.	1973
First National Life Insurance Co. of America	1973
Old Republic Life Insurance Co.	1973
Trans World Assurance Co.	1973
United Services Life Insurance Co.	1973
American Family Life Assurance Co.	1974
Other Foreign Companies	
Nationale-Nederlanden Levensverzekering Maatschappij N.V. (Netherlands)	1986

*As of September 1, 1991.

Source: Ministry of Finance, *Hoken Nenkan (The Insurance Yearbook)* (Tokyo: Okura Zaimu Kyokai, 1991), pp. 860-867.

percent. (In addition to those companies listed in Table 3, four American insurance firms organized as Japanese companies have 0.4 percent of the total market.)

The situation is similar in nonlife insurance. For example, two companies affiliated with AIG, American Home Assurance Co. and AIU Insurance Co., collected 41 percent of all premiums paid to foreign nonlife insurance companies in the year ending March 31, 1991. In second place on this basis was CIGNA Insurance Co., which accounted for 38 percent, leaving only 21 percent for the remaining 32 American and other foreign nonlife insurance companies. All 35 foreign companies together collected only 1.2 percent of all nonlife premiums. (In addition, Allstate Insurance Co., which operates as a Japanese company, claimed a 0.2 percent share of the total market. Japan International Accident and Fire Insurance Co., another AIG subsidiary that began operations in 1989 as a Japanese company, so far has carved out 0.1 percent.)

In a sense the Japanese insurance market would seem to be made-to-order for invasion from abroad. It is profitable, Japanese competitors are regarded as conservative, and the market is growing. Yet American companies, which have earned their competitive wings in the tumultuous U.S. market, have made very limited progress. A number of explanations is possible.

- With the rules of competition essentially established, entrants are precluded from using one classic means of entry — low prices. Instead, they have tried another classic entree, new products. In the past, however, companies such as AFLAC have complained that the approval process has been lengthy, reducing potential profits and providing additional time for other entrants. In response, MOF defenders point to a simplifed approval process in recent years. They also note that MOF regulators have given foreign innovators a period during which they have enjoyed a monopoly,

Table 4: **Foreign Nonlife Insurance Companies Operating in Japan***

Company	Year Licensed
American Companies	
American Home Assurance Co.	1960
Continental Insurance Co.	1972
Federal Insurance Co.	1973
Travelers Indemnity Co.	1974
AIU Insurance Co.	1977
Lumbermen's Mutual Casualty Co.	1981
Transatlantic Reinsurance Co.	1981
CIGNA Insurance Co.	1985
Other Foreign Companies	
Alliance Assurance Co., Ltd. (U.K.)	1950
Commercial Union Assurance Co., P.L.C. (U.K.)	1950
Cornhill Insurance Public Limited Co. (U.K.)	1950
London Assurance (U.K.)	1950
New India Assurance Co., Ltd. (India)	1950
New Zealand Insurance Co., Ltd. (New Zealand)	1950
Northern Assurance Co., Ltd. (U.K.)	1950
Norwich Union Fire Insurance Society, Ltd. (U.K.)	1950
Phoenix Assurance Public Limited Co. (U.K.)	1950
Royal Exchange Assurance (U.K.)	1950
Eagle Star Insurance Co., Ltd. (U.K.)	1951
Assurance Generales de France I.A.R.T. (France)	1956
L'Union des Assurances de Paris I.A.R.D. (France)	1966
QBE Insurance (International) Ltd. (Australia)	1971
Royal Insurance Public Limited Co. (U.K.)	1975
Hyundai Marine and Fire Insurance Co., Ltd. (South Korea)	1976
Ansvar Mutual Insurance Co. (Sweden)	1979
Skandia International Insurance Corp. (Sweden)	1984
Malayan Insurance Co., Inc. (Philippines)	1985
Winterthur Swiss Insurance Co. (Switzerland)	1985
Zurich Insurance Co. (Switzerland)	1986
Assicurazioni Generali S.p.A. (Italy)	1987
Gan Incendie Accidents (France)	1988
General Accident Fire and Life Assurance Corp., P.L.C. (U.K.)	1988
Britannia Steam Ship Insurance Association Ltd. (U.K.)	1989
United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Ltd.	1989
Assuranceforeningen GARD-giensidig (Norway)	1991

*As of September 1, 1991.

Source: Ministry of Finance, *Hoken Nenkan (The Insurance Yearbook)* (Tokyo: Okura Zaimu Kyokai, 1991), pp. 868-891.

a policy akin to patent protection. As a result of such government practices, years after introducing its cancer insurance policy, AFLAC still has close to 90 percent of Japan's cancer insurance market.

- Distribution channels are a problem for insurance companies, as they are in other industries. Foreign firms generally feel they cannot afford to establish the network of housewives selling insurance to other housewives, which is the accepted means of selling many kinds of insurance in Japan. American companies would like to establish agency procedures similar to those in the United States, in which a single insurance agent selects the most appropriate product and insurance company for his or her client and may handle lines from several insurance firms. So far U.S. insurers have made little progress in convincing the Ministry of Finance to permit this option.

Insurance and Keiretsu

In selling insurance packages to corporations foreign firms say they face a problem that overseas companies in other industries also have raised as an issue for government attention. Concerns about linkages associated with *keiretsu*, Japan's large corporate groups, are particularly severe in the case of insurance. Of the seven largest Japanese life insurance companies, all but Dai-Ichi Mutual Life are members of the president clubs of the six major *keiretsu* (see Table 5). The president clubs, which are organizations of 20 to 47 companies whose presidents meet as often as weekly, are considered by some analysts to be the inner circles of the most influential firms associated with Japan's large financial *keiretsu*, which are organized around banks. (For details of the *keiretsu* structure, see *JEI Report* No. 2A, January 12, 1990.) Many observers discount the importance of at least some of these linkages, however. Nippon Life, the nation's largest life insurer, has relationships with so many companies that its membership in the Sanwa Group, one of the weakest groups among the large *keiretsu*, may mean relatively little.

Table 5: **Japan's 10 Largest Life Insurance Companies and Keiretsu**

	Assets March 31, 1991 (in billions)	Market Share	President Club
Nippon Life Insurance Co.	¥27,441	21.1%	Sanwa
Dai-Ichi Mutual Life Insurance Co.	19,185	14.7	None
Sumitomo Life Insurance Co.	16,546	12.7	Sumitomo
Meiji Mutual Life Insurance Co.	11,301	8.7	Mitsubishi
Asahi Mutual Life Insurance Co.	8,816	6.8	Dai-Ichi
Mitsui Mutual Life Insurance Co.	7,082	5.4	Mitsui
Yasuda Mutual Life Insurance Co.	6,163	4.7	Fuyo
Chiyoda Mutual Life Insurance Co.	5,154	4.0	None
Taiyo Mutual Life Insurance Co.	4,844	3.7	None
Toho Mutual Life Insurance Co.	4,749	3.6	None
Total for President Club Members*	79,839	61.3	
Total for Industry	130,251	100.0	

*Includes total for Fukoku Mutual Life Insurance Co., a member of the Dai-Ichi President Club.

Source: *Toyo Keizai Geppo* and Ministry of Finance, *Hoken Nenkan (Insurance Yearbook)* (Tokyo: Okura Zaimu Kyokai, 1991), p. 203.

A similar situation exists with respect to nonlife companies. As shown in Table 6, the largest nonlife insurance companies are members of president clubs. In addition, their largest stockholder typically is a member of the same president club, an indication of the financial linkages that exist within a corporate group. While the next-largest companies usually are not members of a president club, their largest stockholder often is, tying them however indirectly to the group.

Table 6: **Japan's 10 Largest Nonlife Insurance Companies and Keiretsu**

	Assets/ (in billions) Share March 31, 1991	President Club	Largest Shareholder/ Its Membership
Tokio Marine & Fire Insurance Co., Ltd.	¥4,588 17.5%	Mitsubishi	Mitsubishi Bank, Ltd. Mitsubishi
Yasuda Fire & Marine Insurance Co., Ltd.	3,508 13.4%	Fuyo	Fuji Bank, Ltd. Fuyo
Mitsui Marine & Fire Insurance Co., Ltd.	2,385 9.1%	Mitsui	Mitsui Mutual Life Insurance Co. Mitsui
Sumitomo Marine & Fire Insurance Co., Ltd.	2,156 8.2%	Sumitomo	Sumitomo Trust & Banking Co., Ltd. Sumitomo
Nippon Fire & Marine Insurance Co, Ltd.	1,844 7.0%	None	Hitachi, Ltd. Sanwa and Dai-Ichi
Nichido Fire & Marine Insurance Co., Ltd.	1,648 6.3%	None	Fuji Bank, Ltd. Fuyo
Dai-Tokyo Fire & Marine Insurance Co., Ltd.	1,379 5.3%	None	Nomura Land and Building Co., Ltd. None
Koa Fire & Marine Insurance Co., Ltd.	1,140 4.4%	None	Nippon Express Co., Ltd. Sanwa, Dai-Ichi
Fuji Fire & Marine Insurance Co., Ltd.	1,132 4.3%	None	Daiwa Bank, Ltd. None
Chiyoda Fire & Marine Insurance Co., Ltd.	1,124 4.3%	None	Toyota Motor Corp. Mitsui
Total for President Club Members*	13,910 53.1%		

*Includes Nissan Fire & Marine Insurance Co., Ltd. and Taisei Fire & Marine Insurance Co., Ltd., both members of the Dai-Ichi President Club.

Source: *Toyo Keizai Geppo* and Ministry of Finance, *Hoken Nenkan (Insurance Yearbook)* (Tokyo: Okura Zaimu Kyokai, 1991), p. 414.

Although many American and Japanese economists minimize the importance of the *keiretsu* structure in limiting competition in Japan, its importance in the insurance industry arguably is greater than elsewhere as a result of the lack of competition. (For details of this debate with respect to the role of *keiretsu* in limiting market access for imported goods, see *JEI Report* No. 22A, June 14, 1991.) In the procurement of most goods and services companies may see little advantage in dealing with fellow *keiretsu* firms if such companies are uncompetitive. However, with competition in the Japanese insurance industry severely limited, companies may gravitate toward their *keiretsu* life or nonlife insurance company. A 1987 report commissioned by Japan's Fair Trade Commission concluded that was the case in a comparison of corporate procurement practices of several manufactured goods and insurance services.

> As suggested by the above results, the reasons for choosing a supplier vary substantially by product. For facsimile machines and mainframe computers, product quality, in the broad sense, was given the most weight, followed by cost. Relationships with supplier companies were a minor factor. ...
>
> In contrast, group ties and fostering financial links were the primary factors determining the choice of pension fund placement and insurance suppliers, with 95.9 percent of respondents identifying one of these as the reason for choosing a pension fund manager and 75.3 percent identifying it as the primary factor in choosing their current insurance company. ...[3]

The report pointed out that life insurance companies and trust banks are the major managers of pension funds in Japan. It also noted that most of the companies surveyed by the FTC group had multiple suppliers of financial services. For smaller Japanese firms as well as foreign companies trying to sell insurance in Japan, the implication would appear to be obvious: the lack of competition in both types of insurance provides buyers an excuse to apply noncompetitive criteria in choosing their insurers.

Another characteristic of companies that belong to *keiretsu* president clubs is that participating firms hold stock in fellow *keiretsu* members. This means that big insurance companies may be large stockholders in their potential clients. (This pattern often exists even in the absence of a formal *keiretsu* structure.) Even without such positions, they simply may keep the business they already have as a result of the preference of Japanese companies for long-term relationships. In short, the argument that *keiretsu* act as an impediment to market access to U.S. firms may be stronger with respect to the insurance industry than it is for other industries.

Insurance as an International Economic Issue

The *keiretsu* connection has played an important role in turning Japan's insurance industry into a subject for talks between the United States and Japan. In recent years the industry has been a focus of at least two major series of negotiations.

In the ongoing discussions that follow up the 1989-90 Structural Impediments Initiative talks Washington has focused on the *keiretsu* structure as a trade barrier, thereby potentially raising the issue of the structure of the insurance industry. During a February meeting SII negotiators from both sides used the Japanese insurance industry as one of the case studies of the structural problems encountered by foreign companies trying to break into the Japanese market (see *JEI Report* No. 9B, March 6, 1992). A final list of new commitments from the Japanese side is expected this summer. Participants in the process emphasize that insurance per se has not been a subject of negotiation.

In a related development *Nihon Keizai Shimbun*, Japan's large economic daily, reported in mid-April that Washington has pressed Tokyo to make a public commitment to rectify problems that a July 1991 FTC-commissioned report identified concerning industries excluded from enforcement under the Antimonopoly Act. According to the FTC report, insurance industry practices — especially with regard to the pricing of marine and aviation insurance — are among the 41 legal exclusions from that act. Washington presumably wants Tokyo to legalize FTC antitrust action against insurance companies.

Further from the public eye, but arguably more important, are the talks concerning insurance in the Uruguay Round of multilateral trade negotiations (see *JEI Report* No. 8B, February 28, 1992). Japan, the United States and 106 other members of the General Agreements on Tariffs and Trade are involved in negotiations that began in late 1986 on a wide range of issues. Most public attention has focused on disagreements involving the United States, the European Community and — to a limited extent — Japan over agricultural issues, but the Uruguay Round covers many other areas as well.

The services sector, which includes insurance and other financial services, has its own set of concerns. The current draft text of a services agreement lays out broad principles that serve to guide negotiations in individual industries, such as insurance. From the U.S. perspective the key concepts are market access and national treatment (treating foreign concerns in the same way in which domestic companies are treated). However, participants in the Uruguay Round have not accepted this text.

Despite the uncertain foundation created by the failure to agree on an overall draft text, Japan, the United States and many other nations this year began what is known as a request-and-offer process regarding services. For example, in bilateral negotiations Washington has sought certain changes in Japan's insurance market and has asked Tokyo to identify what policies and practices in Japan might be inconsistent with GATT principles and open to negotiation. If the process goes as planned, Tokyo eventually will agree to a series of liberalizing measures reflecting negotiated agreements that balance requests from each of its partners with Tokyo's own offers. (In general, while both industrial and developing nations participate in the request-and-offer process, the negotiations involving the United States, the world's biggest market, obviously loom very large.)

Among specific U.S. complaints concerning the Japanese insurance market is Washington's argument that foreign insurance companies are more restricted concerning their investment activities in Japan than are domestic concerns — in short, a denial of national treatment. In addition, Washington has taken exception to Japan's restrictions concerning the use of insurance agencies. In the United States an individual seeking insurance can go to an agent who represents several companies. In Japan the agent is restricted to handling the business of only one company, thereby raising the question of whether market access is adequate for foreign companies inasmuch as their distribution costs are likely to be unusually high in the start-up phase. Somewhat the same problem exists with what are known as insurance brokers. In the United States brokers act as intermediaries on behalf of firms seeking insurance; they offer advice to clients and negotiate price with insurance companies. Brokers are not allowed in Japan.

Many issues still await resolution concerning international trade in insurance services. But even if the insurance talks eventually succeed, they could come to nothing if the Uruguay Round fails for other reasons. Given the lack of progress in agriculture and the busy 1992 political calendar, few observers expect that final approval of any agreement is likely before next spring, if then.

Conclusion

In Japan insurance industry practices sometimes are compared to a man with a hammer contemplating crossing a bridge. He hammers each stone, determining it to be solid, eventually reaching the middle of the bridge. Finding the middle stone solid as well, he proceeds back to the side from which he began. Today the Japanese industry faces a dilemma, perceiving the need to cross the bridge yet afraid that it might collapse under the industry's enormous weight. In some respects insurers so far have crossed the bridge halfway. Japanese government officials and insurance policyholders, as well as many insurance companies and policymakers abroad, are waiting to see whether Japan's reluctant insurance giants will continue toward the other side.

For further information, contact **Douglas Ostrom.**

Dan Levison provided research assistance.

Notes

[1] Allan D. Affleck and Stephen H. Conwill, "The Progress of Foreign Companies in the Japanese Life Insurance Market," *Japan Insurance News*, July/August 1991, p. 34.

[2] Ryutaro Komiya, *The Japanese Economy: Trade, Industry and Government* (Tokyo: University of Tokyo Press, 1990), pp. 233-264.

[3] Fair Trade Commission, *Long-Term Relationships Among Japanese Companies: A Report by the Study Group on Trade Frictions and Market Structure* (April 1987), pp. 6-7.

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JEI REPORT

A Two-Part Report: A and B

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G-7 Pressures Japan On Economy

In late April the world got two glimpses of Japan's new role on the world economic policymaking stage. Japanese analysts sometimes have complained in the past that their nation has not had the attention it deserves in international forums. Such attention definitely was not lacking April 26 as the finance ministers and central bankers of the Group of Seven industrial nations met in Washington. The G-7's focus on Japan followed a meeting on the other side of the Pacific a few days earlier in which Japanese officials had dealt a blow to the idea that Japan seldom takes the initiative in international meetings. They pushed, albeit unsuccessfully, for measures that they hoped would reinvigorate the stalled Uruguay Round of multilateral trade negotiations.

The communique issued at the end of the longer-than-scheduled G-7 session avoided direct mention of Japan but was unmistakable in its signal that Tokyo take strong countermeasures, beyond those already announced, to strengthen both its currency and its economy. The meeting occurred at a time when the weakness of the Japanese stock market was a hot topic in America's news media and even on Capitol Hill, where Federal Reserve Board chairman Alan Greenspan had assured an April 17 congressional hearing that the U.S. economy was not seriously threatened by depressed Japanese equity prices. In addition, American analysts have worried that the weakness of the Japanese economy itself could pose problems for the fragile American economic recovery. However, that linkage often has been exaggerated (see *JEI Report* No. 15B, April 17, 1992).

diplomatic notes that established the flow-back concept, concurs that this is only a portion of what Japan could be doing. Mr. Rubinstein has suggested, however, that the U.S. side also could be doing a better job of identifying the specific technologies in which it is interested.

The P-3C navigational technology actually is the second such transfer that Tokyo has approved. Last December KHI agreed to share another P-3C innovation — engine equipment that provides electricity to the aircraft's radar. KHI's design evidently operates more reliably and does not require as much oil as the original Lockheed-developed system. Defense officials have indicated that the Pentagon is reviewing as many as four additional technology transfer requests.

Barbara Wanner

Peru Presents Dilemma For Japan

President Alberto Fujimori's April 5 actions suspending democracy in Peru presented that country's neighbors and allies with a difficult decision. While recognizing the serious problems Peru faces, ranging from the Maoist Shining Path guerrillas to government corruption, few, if any, concerned governments endorsed Mr. Fujimori's actions. Instead, foreign capitals have taken steps intended to press the Peruvian president to restore democracy immediately. Washington responded April 6 by suspending new aid to Peru and urging coordination by donor nations to impress upon Lima that aid and other economic support will be withheld until democratic institutions are reestablished. Japan, which promised Peru significant new development assistance last month, describes its stance on aid to Lima as "open," a position that some have questioned.

The 1990 election of Mr. Fujimori, the first ethnic Japanese to be elected head of a country other than Japan, raised Peru's profile in Japan. Tokyo promised Peru a $4.5 million grant during Mr. Fujimori's July 1990 preinaugural trip to Japan but conditioned additional assistance on Lima's adoption of an economic reform plan and fulfillment of the international financial community's demands (see *JEI Report* No. 27B, July 13, 1990).

Since Mr. Fujimori came to office, Japan and the United States have been among Peru's largest donors. In 1990 Tokyo extended nearly $40 million in official development assistance to Lima, half of which was provided in the form of financial grants (see Table). This was followed in 1991 by $26 million in grant assistance as well as a $400 million loan committed and almost completely disbursed last December. The loan, co-financed by the Inter-American Development Bank, was intended to cover commodity import payments and bolster Peru's Trade Adjustment Program.

Japan's Official Development Assistance to Peru, 1986-90

(in millions of dollars, net disbursement basis)

	Grants			
	Grant Aid	Technical Cooperation	Loans	Total
1986	$7.6	$14.5	$10.2	$32.3
1987	13.6	18.3	5.7	37.6
1988	7.5	19.3	1.6	28.4
1989	6.1	19.7	2.1	27.9
1990	20.4	19.1	0.4	39.8

Source: Ministry of Foreign Affairs

Japan's most recent pledge to assist Peru came during President Fujimori's mid-March trip to Tokyo. At that time the Japanese government announced a package of $100 million worth of yen loans as well as nonproject grant assistance totaling ¥3.5 billion ($26 million at ¥135=$1.00). Ministry of Foreign Affairs spokesman Masamichi Hanabusa said that the package also included technical training in Japan for 500 Peruvian engineers; the first trainees are scheduled to arrive this year. Citing Peru's progress in controlling inflation and imposing economic discipline, Mr. Hanabusa noted: "Peru's efforts deserve strong support, and since their president is a Japanese Peruvian, there is a great deal of interest in Peru and in the success of President Fujimori's efforts among the Japanese people." The Japanese government considers Peru "a model for economic and political reform in Latin America" and wants to support the Fujimori government, Mr. Hanabusa added.

Japanese officials called Mr. Fujimori's April 5 decision to disband Peru's parliament, imprison opposition leaders and suspend the constitution "a regrettable setback," adding that Japan "strongly desires that the situation quickly return to normalcy and that [Mr. Fujimori's] reform efforts be continued in accordance with the democratic process." Tokyo initially indicated, however, that it did not intend to suspend aid to Peru immediately but would watch developments there.

The Foreign Ministry's Mr. Hanabusa noted that Tokyo would take into consideration international reactions, including that of the Organization of American States, in deciding the aid issue. At an April 13 ad hoc meeting of the OAS the foreign affairs ministers of the member countries passed a resolution strongly deploring events in Peru and calling for the immediate reestablishment of democratic institutional order there. Japan was among the observers at this meeting. Soon after, Mr. Hanabusa indicated that the Japanese government was studying the OAS resolution while continuing to watch developments in Peru. Questioned by the press about the implications of Japan's position on aid to Peru, Mr. Hanabusa asserted, "The objective of our assistance is to help the Peruvian people, not the government as such." Lack of a decision was not a decision in itself, he said, noting, "We have not decided not to stop assistance, nor have we decided to stop it."

Mr. Hanabusa acknowledged that Mr. Fujimori's actions "posed a dilemma for Japan," but he added that Tokyo was watching the Peruvian people's response to the president's timetable for the restoration of democracy since, "It is first and foremost up to the Peruvian people to decide how their democratic principles should be put into practice." While Japan supports movement toward democracy, he added, "It is a question of how to do so." Press reports noted that the Foreign Ministry called President Fujimori's April 21 announcement of plans to return to constitutional rule in stages over the year ahead an "important step toward normalization."

In Washington the months-long timetable met with greater wariness. Department of State officials said that the leader's schedule for a series of referenda and votes, while an improvement over earlier proposals, "would still leave Peru without constitutional processes for nearly a year." By some estimates $13 billion of U.S. economic and military aid to Peru has been put on hold since April 5. In addition, Washington reportedly has urged other nations as well as multilateral financial institutions to make clear to Lima that new aid, debt assistance and acceptance of Peru in international economic circles hinge on the restoration of democracy. The economic reforms that had earned Mr. Fujimori praise from various allies are considered unsustainable without foreign aid.

The strict stance toward Mr. Fujimori spearheaded by the United States is in contrast to Japan's measured response to developments in Peru. New guidelines announced a year ago by then Prime Minister Toshiki Kaifu called on the Japanese government to take into consideration military and political policies of a recipient nation — including its stand on the promotion of democracy and on human rights safeguards — before extending foreign aid (see *JEI Report* No. 16B, December 6, 1991). Although the Japanese government has indicated that the principles will be applied on a case-by-case basis, some observers are likely to measure Tokyo's approach to challenging political developments such as those in Peru against these year-old guidelines.

Margo Grimm

Notes

Car Export Quota - Japan's automotive manufacturers are reviewing their strategies for the U.S. market now that they know how the new 1,650,000-unit ceiling on U.S.-bound car exports during FY 1992 will affect them. As expected (see *JEI Report* No. 12B, March 27, 1992), the Ministry of International Trade and Industry divvied up the new quota by first comparing each exporter's actual shipments in the April 1990-March 1991 and April 1991-March 1992 periods to its allocation under the old 2,300,000-unit cap and then making allowances for U.S. production capabilities and financial health. That formula generally helped second-tier car companies at the expense of Japan's five biggest exporters (see Table).

Unofficial Quota Allocations, FY 1981-FY 1992

(in units)

Exporter	FY 1981-FY 1983 Quota	FY 1984 Quota	FY 1985-FY 1986 Quota	FY 1987 Quota	FY 1988 Quota	FY 1989-FY 1991 Quota	FY 1992 Quota
Toyota Motor Corp.	516,659	551,792	616,900	613,816	612,350	610,350	480,000
Honda Motor Co., Ltd.	348,631	372,338	427,000	424,865	423,850	421,850	320,000
Nissan Motor Co., Ltd.	456,030	487,040	544,500	541,778	540,500	532,500	300,000
Mazda Motor Corp.	159,282	173,468	227,800	226,661	226,100	226,100	200,000
Mitsubishi Motors Corp. (including sales to Chrysler Corp.)	112,584	122,612	195,100	194,125	193,650	193,650	150,000
Isuzu Motors, Ltd. (including sales to General Motors Corp.)	16,800	49,500	120,400	119,798	119,500	124,500	100,000
Fuji Heavy Industries, Ltd.	70,014	76,250	107,600	107,062	106,800	106,800	70,000
Suzuki Motor Co., Ltd. (for sale to General Motors Corp.)	0	17,000	60,700	60,397	60,250	64,250	30,000
Daihatsu Motor Co., Ltd.	0	0	0	11,498	17,000	20,000	0
Total	1,680,000	1,850,000	2,300,000	2,300,000	2,300,000	2,300,000	1,650,000

Financially troubled Isuzu Motors Ltd. and Fuji Heavy Industries, Ltd. received allotments estimated to be larger than their actual FY 1991 shipments, while Suzuki Motor Co., Ltd., the smallest exporter now that Daihatsu Motor Co., Ltd. is out of the American car market, will be able to ship about the same number of cars it did in the year through March. Mazda Motor Corp. also emerged relatively unscathed from the reallocation process, in part apparently because it filled a higher percentage of its quota in FY 1991 (roughly 92 percent) than any other company. In contrast, Toyota Motor Corp., Honda Motor Co., Ltd. and Mitsubishi Motors Corp., which all used 80 percent-plus of their allocation in the recently completed fiscal year, will have to trim exports in the 12 months through March 1993 by about the same relative amount — 6 to 8 percent — as Nissan Motor Co., Ltd., which filled only 61 percent or so of its allotment in FY 1991. In absolute terms Toyota will lose approximately 34,000 units of future supply capability, Honda 20,000 units, Nissan 23,000 units, Mazda 8,000 units and MMC 13,000 units.

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GLOBALIZATION, ECONOMIC REALITIES FORCE STATES TO REASSESS THEIR OVERSEAS PROGRAMS

SUMMARY

Exploring trade and investment possibilities overseas has been an element of states' overall economic development efforts for at least two decades. State overseas offices, on the frontline in the bid to attract foreign direct investment as well as to boost exports, are concentrated in Asia, with the largest number located in Japan. This reflects the importance of transpacific trade. Recently, however, political and economic developments at the local and the international level have compelled many states to review the role of their overseas offices.

Faced with a decline in new Japanese direct investment in this country since 1990, several state offices in Japan have shifted their efforts toward export promotion. Moreover, tighter budgets have forced some states to close their Japan offices and others to consider new options for promotion there. Changes in state operations in Japan and elsewhere are likely to continue as state leaders examine the effectiveness of their overseas representation and consider the states' role in trade expansion in light of a new federal government emphasis on export promotion. At the same time, as Washington and its allies work toward new multilateral trade agreements, states will be seeking a larger voice in the international rules that they see increasingly affecting their trade-related operations.

Overview

Over the last two decades international opportunities have loomed increasingly large in the economic development plans of governors, according to Wisconsin's Gov. Tommy Thompson, the former chairman of the National Governors' Association Committee on International Trade and Foreign Relations.[1] Gov. Thompson has written that state leaders have greater flexibility than federal officials to shape trade strategies that fit the requirements of both local companies and the international market. Among state efforts to expand trade and investment, the Wisconsin governor noted, are programs to promote joint ventures, foreign investment and tourism as well as to provide export financing and such technical assistance as seminars, business counseling and trade leads. He emphasized that overseas missions headed by governors also have helped to expand exports and attract investment and tourism. In 1990 governors led 82 such trips.

State overseas offices are another element of trade and investment promotion efforts. The National Association of State Development Agencies placed the number of state overseas offices or representatives at 163 in 1990, the latest year for which complete data are available. In 1990 Japan had the largest concentration of state offices or representatives, with a total of 41. Slightly more than half were government-run facilities, the others were contract arrangements. State interest in pursuing opportunities in Asia was reflected further by the next two top locations for offices or representatives, Taiwan and South Korea, which numbered, respectively, 22 and 16 in 1990. Among the states that had no representation in Japan in 1990 several (Arizona, Idaho, Rhode Island and Wyoming) had Taiwan offices addressing their Asian interests. Those with representative offices across the Atlantic included 15 in Belgium, followed by 14 in West Germany. A handful of states — including Maine, Nebraska, New Hampshire, New Mexico, South Dakota and Vermont — had no overseas offices as of 1990.

While Japan still is host for the largest number of state overseas offices, state representation there has undergone some changes since 1990. Currently there are 36 state offices or representatives in Japan. Texas, Maryland and Louisiana have closed their Japan operations since 1990, while Connecticut and Pennsylvania have reduced their representation to part-time minimal status. In addition, the State of Utah has restricted its trade representation in Tokyo, although it maintains tourism promotion efforts there, according to officers of the Tokyo-based American State Offices Association, which since 1980 has helped its members coordinate their efforts in Japan. Utah state officials say they are awaiting the assignment of a new director and that the office will be reestablished soon. Maryland, which closed its Japan office in late March 1992 in response to significant cutbacks in the state budget, also hopes to reopen its Tokyo office. The State of Texas characterizes the shutdown of its Tokyo operations as a temporary move. Texas state officials say they hope to start up a new office by June, although they admit that budget reallocations make a scaled-back operation likely. Louisiana, whose exports to Mexico expanded 95 percent from 1987 to 1990, decided to shift scarce resources to meet business demands regarding export opportunities in Latin America. The state has no plans to reopen its Tokyo office, even though Japan was Lousiana's top export market in 1990, purchasing $2.6 billion of that state's total exports. Louisiana officials indicate that one factor in the decision to close the Tokyo office is the range of services available to exporters interested in that market from other sources, including those provided by the Japanese government.

With most states facing similar budget constraints, many are expected to reevaluate their Tokyo representation. While for some states this may mean adjusting the scope of their Japan operations to fit new fiscal conditions, ASOA officers predict other Tokyo offices will close in the future. For its part, the association participates in trade shows and seminars and works with industry associations, the American Chamber of Commerce in Japan, the quasi-governmental Japan External Trade Organization and other groups. In presenting a unified front, ASOA officials point out, the states can increase their political leverage and heighten their exposure in Japan.

Changes Within the States

The first challenge for most of the 19 new governors elected in 1990 was dealing with their states' economic difficulties, including declining revenues and the competing demands for what money

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was available. Trends in the economy have a direct impact on state budgets, which, with the exception of Vermont's, must be balanced each year. Most state offices in Japan have felt the repercussions of budget restrictions resulting from the recession that took hold in late 1990. Jody Thomas, director of the NGA's Committee on International Trade and Foreign Relations, points to the closer scrutiny of state overseas operations by local government over the past 18 months. State leaders have been looking at revising the role of such operations, making staffing changes and defining criteria for evaluating the performance of overseas offices, Ms. Thomas notes.[2]

In addition, the 1990 elections brought 13 states under the administration of a different party, resulting in a reassessment of priorities in many statehouses. A number of state representatives in Tokyo report that these shifts in state leadership have precipitated recent changes in their offices' activities. Jack Savas, managing director of Michigan's Japan Operations, says that the principal focus of the Tokyo office in the late 1980s was to attract foreign direct investment to the state, with the hope of creating jobs for dislocated automotive workers. Preliminary estimates indicate that at the end of 1989 direct investment in Michigan by Japanese-controlled affiliates totaled $2.5 billion and accounted for 19,500 jobs in the state (see Tables 1 and 2). When Republican John Engler took over from Democratic two-term incumbent Gov. James Blanchard following the 1990 election, Mr. Savas notes, his administration gave new priority to introducing Michigan producers to Japanese buyers.[3] Michigan's overall exports to Japan totaled $773 million in 1990. Even when the governorship stayed in the same party, the same approach was not assured. Michael Hayes, formerly the chief representative of the Commonwealth of Kentucky's Far East Representative Office in Tokyo, says that a policy review initiated by Democratic Gov. Brereton Jones, inaugurated last December after the expiration of the term of fellow Democrat Gov. Martha Layne Collins, has highlighted the importance of trade promotion rather than investment attraction efforts.[4]

Adjusting to Declining Japanese Investment in the United States

The slowdown in Japanese direct investment in the United States also has compelled states to reassess their operations in Japan. The boom in Japanese spending to establish, purchase or expand production facilities in the United States ended in 1989 (see *JEI Report* No. 46A, December 13, 1991). By then many major Japanese exporters already had U.S. production facilities in operation and had shifted their attention to other areas of the world, particularly Europe. More recently, the state of the Japanese economy has dampened the immediate prospects for an upturn in Japanese direct investment in this country.

Kentucky's experience is illustrative of the benefits from the Japanese investment boom — and the response to its ebb. That state's former Far East representative, Mr. Hayes, notes that a rush of automotive-related manufacturing investment followed Toyota Motor Corp.'s decision to build a production complex in Georgetown. Kentucky currently has 72 Japanese manufacturing plants; there were nine in 1985. Although the boom continued through January 1990, once automotive parts suppliers were in place and the economy had slowed, Kentucky saw a dramatic drop in investor interest, Mr. Hayes says. After recognizing this development, Kentucky turned its attention to export promotion. The shift has been very recent; the Tokyo office devoted 90 percent of its attention to investment attraction until last year. Now export promotion and investment attraction have about equal emphasis in that office. Mr. Hayes considers three new in-state Japanese plants a year a successful rate these days, in contrast to the 19 production facilities announced in 1989.

Investment attraction still has a place on most states' Tokyo office agendas, and a number of representatives continue to concentrate on this task. Some observers see the shift toward export promotion as a matter of expanding the state office role to include these functions rather than cutting out investment attraction responsibilities. Yet a number of state representatives describe their investment attraction role as more passive than it was previously. They note that the time they devote to investment attraction has decreased not only because economic developments have narrowed the number of projects but because potential investors are more informed about the business environment

Table 1: Gross Property, Plant and Equipment of Nonbank Affiliates of Foreign Companies, State by Country of Ultimate Beneficial Owner, 1987-89

(in millions of dollars)

	1987		1988		1989*	
	Japan	Total	Japan	Total	Japan	Total
New England						
Connecticut	$67	$3,092	$177	$3,810	$201	$4,718
Maine	3	1,549	22	2,035	33	2,110
Massachusetts	387	5,214	588	6,516	757	7,580
New Hampshire	88	736	102	994	123	1,141
Rhode Island	18	605	26	580	(D)	931
Vermont	6	382	16	449	17	502
Mideast						
Delaware	37	3,432	60	4,789	75	5,378
District of Columbia	186	1,655	419	2,230	655	2,433
Maryland	134	3,124	188	3,766	462	4,812
New Jersey	768	11,458	1,235	13,980	1,488	16,011
New York	5,170	23,069	6,508	26,366	8,518	31,993
Pennsylvania	271	10,898	585	11,582	748	14,984
Great Lakes						
Illinois	2,426	12,920	3,514	16,699	4,512	19,610
Indiana	594	4,183	1,338	5,928	1,891	8,106
Michigan	1,790	7,640	2,134	8,774	2,494	10,220
Ohio	1,536	10,622	2,320	12,912	4,273	17,315
Wisconsin	110	2,803	107	3,674	142	4,349
Plains						
Iowa	74	1,663	382	2,219	422	2,356
Kansas	33	2,350	113	5,254	141	4,717
Minnesota	(D)	4,344	426	5,540	757	11,410
Missouri	81	4,233	128	4,484	181	5,024
Nebraska	24	459	37	556	54	700
North Dakota	5	1,295	2	1,169	8	1,121
South Dakota	7	378	(D)	441	(D)	456
Southeast						
Alabama	368	4,011	521	4,852	637	5,855
Arkansas	130	1,289	410	1,707	501	2,263
Florida	233	9,574	335	11,905	401	14,316
Georgia	713	9,059	1,013	10,856	1,555	13,873
Kentucky	703	4,557	1,408	5,581	2,019	6,750
Louisiana	84	14,292	205	15,898	223	15,661
Mississippi	41	2,425	(D)	2,579	78	2,606
North Carolina	404	9,727	823	11,792	1,451	13,869
South Carolina	165	6,182	558	7,289	628	8,572
Tennessee	1,134	5,604	1,531	7,292	1,852	8,771
Virginia	112	6,808	232	7,982	484	9,137
West Virginia	(D)	5,060	214	5,020	225	5,511
Southwest						
Arizona	104	4,103	434	5,060	489	5,859
New Mexico	16	2,751	27	3,569	(D)	3,881
Oklahoma	76	5,088	383	5,709	408	5,726
Texas	841	41,591	1,296	46,213	1,755	48,176
Rocky Mountains						
Colorado	103	4,487	187	5,469	286	5,716
Idaho	1	395	45	432	53	618
Montana	5	1,684	7	1,801	9	1,917
Utah	6	2,610	10	3,502	16	3,391
Wyoming	1	2,962	1	2,990	4	1,958
Far West						
California	8,464	44,275	11,702	52,411	14,627	61,142
Nevada	(D)	1,606	266	2,653	334	3,747
Oregon	391	1,812	493	2,099	667	2,299
Washington	796	3,588	1,118	4,803	1,398	5,914
Alaska	352	18,420	379	18,312	501	18,919
Hawaii	2,969	3,474	4,235	4,990	5,975	6,888
Puerto Rico	61	558	83	663	78	997
Other U.S. Areas	118	15,019	137	17,247	153	17,579
Total	32,924	351,113	48,547	415,423	65,593	479,889

*Preliminary.

Note: (D) indicates data have been suppressed to avoid disclosure of data on individual companies.

Source: Department of Commerce

Table 2: Employment of Nonbank Affiliates of Foreign Companies, State by Country of Ultimate Beneficial Owner, 1987-89

(in thousands of employees)

	1987		1988		1989*	
	Japan	Total	Japan	Total	Japan	Total
New England						
Connecticut	2.4	57.0	3.9	72.3	4.4	87.7
Maine	0.1	20.6	0.5	24.4	0.4	27.1
Massachusetts	8.1	92.5	11.1	110.3	13.6	129.0
New Hampshire	1.8	18.9	2.5	22.4	2.6	25.6
Rhode Island	0.4	10.5	0.5	12.2	0.5	13.3
Vermont	(D)	6.0	0.4	7.9	0.4	8.4
Mideast						
Delaware	0.4	36.8	1.1	41.8	1.1	41.5
District of Columbia	0.3	7.0	0.9	8.8	1.0	8.8
Maryland	2.7	53.8	3.0	62.1	3.4	68.6
New Jersey	16.2	173.3	21.2	203.9	24.2	222.4
New York	36.8	302.8	40.4	342.8	42.8	370.9
Pennsylvania	5.0	166.9	8.6	179.0	10.1	201.4
Great Lakes						
Illinois	21.6	168.2	33.7	214.1	37.5	238.6
Indiana	3.9	67.4	8.2	83.4	9.4	96.5
Michigan	13.7	96.3	17.6	116.2	19.5	140.1
Ohio	12.4	132.9	20.9	170.2	34.5	207.6
Wisconsin	2.0	54.9	2.8	71.1	3.0	77.0
Plains						
Iowa	0.6	20.4	2.8	28.6	3.0	30.6
Kansas	0.6	19.9	1.3	27.8	1.4	30.0
Minnesota	2.3	40.2	3.0	51.4	3.2	81.2
Missouri	1.7	50.2	2.9	59.0	3.6	71.6
Nebraska	0.3	7.6	0.8	12.7	0.9	13.5
North Dakota	**	2.7	0.1	2.7	0.1	3.1
South Dakota	0.1	1.9	0.1	2.9	0.1	3.0
Southeast						
Alabama	4.1	35.4	5.8	42.0	6.5	55.8
Arkansas	1.6	21.3	3.9	25.7	5.2	32.0
Florida	9.4	124.0	13.9	154.1	8.9	186.5
Georgia	10.7	122.4	14.6	143.7	17.2	159.7
Kentucky	3.1	38.5	6.1	47.7	13.1	55.5
Louisiana	0.4	51.3	1.7	56.2	1.7	64.6
Mississippi	1.3	17.5	1.7	20.2	1.8	22.8
North Carolina	4.0	134.1	7.2	157.4	9.6	174.5
South Carolina	2.9	75.7	6.7	85.1	6.9	100.1
Tennessee	8.0	82.2	11.9	98.2	12.8	112.3
Virginia	2.0	79.7	3.6	92.7	4.9	106.1
West Virginia	0.2	25.4	0.9	26.6	1.0	29.8
Southwest						
Arizona	1.8	43.5	4.3	48.0	4.3	54.2
New Mexico	**	14.1	0.3	15.1	1.5	15.6
Oklahoma	0.7	27.2	2.7	38.4	3.0	41.2
Texas	8.6	210.1	14.6	236.4	18.2	263.8
Rocky Mountains						
Colorado	1.3	28.3	2.1	34.2	3.1	40.0
Idaho	0.1	4.0	(D)	5.6	(D)	8.2
Montana	0.1	3.7	0.1	3.8	0.3	4.1
Utah	0.2	12.6	0.4	15.4	0.5	16.1
Wyoming	**	4.3	0.1	3.9	0.1	4.1
Far West						
California	71.3	334.9	86.6	407.1	102.6	496.4
Nevada	(D)	10.5	(D)	13.7	(D)	18.7
Oregon	3.2	21.0	4.2	25.1	6.9	28.5
Washington	5.8	40.6	9.7	55.8	10.0	67.2
Alaska	1.8	7.5	2.5	7.6	2.4	8.0
Hawaii	20.6	27.3	24.3	34.8	29.6	42.7
Puerto Rico	2.5	12.8	2.9	14.7	2.7	19.6
Other U.S. Areas	1.6	4.0	1.8	4.6	1.9	8.8
Total	303.1	3,222.7	426.7	3,841.6	502.1	4,434.4

*Preliminary.
**Fewer than 50 employees.

Note: (D) indicates data have been suppressed to avoid disclosure of data on individual companies.

Source: Department of Commerce

in the United States and state offices are more familiar with the process. John Hemmer, representative and managing director of Japan Operations for the State of Illinois, notes that because his office has been doing investment promotion for a long time, "The type of information needed for an investment project we can handle quite easily, speedily and efficiently," compared to when the program was started.[5] A number of state representatives suggest that the responsibility for attracting investment also has been lightened by the active role some state and city chambers of commerce have taken in pursuing foreign direct investment.

Some states also have revised their approach to investment attraction in response to public concerns. Several years ago many state governments came under fire for using tax incentives and other enticements to draw foreign investment. Recently some statehouses have downplayed incentive packages while boosting efforts to increase public awareness of the benefits of foreign direct investment. At the same time Japanese companies in this country have become more attuned to the corporate citizenship responsibilities expected of them (see *JEI Report* No. 18A, May 4, 1990).

New Challenges for State Overseas Offices

The shift toward export promotion parallels an increased awareness of trade as a critical issue in U.S.-Japan relations as well as the federal government's expanding emphasis on boosting U.S. exports, according to state representatives in Tokyo. The most compelling reason for states in many regions to pursue export opportunities, however, rests in market realities.

Options for State Representation - While some states may see a need to downsize their Tokyo operations from full-scale offices to contract arrangements or part-time consultants, others are looking into different ways to ease their budget constraints. One idea instituted by Michigan's Japan Operations office and under discussion in other states is to operate under a fee schedule. Some states currently request contributions from the business community to cover certain costs. Others have cut expenses by sharing office space with state private-sector organizations.

A number of states also are considering joining forces in regional offices. South Carolina's Jack Yamashita, who notes that his state is active in U.S.-based regional associations aimed at improving ties with Japan, says one benefit of a regional effort is that competition among states begins among regions. But after that, he cautions, each state has to have "someone that is willing to fight for [his or her] own state." Among the problems raised over the use of regional offices are whether states' diverse fiscal years and the lack of confidentiality would hurt the offices' chances of success. Offering a more positive perspective is a 1989 study conducted for the Western Governors' Association; it observed that overseas trade officers typically serve exporters rather than states. The study concluded that consolidating efforts for export promotion "is more feasible than collaboration on investment promotion which is more directly competitive."[6]

Measuring the Effectiveness of State Overseas Offices - As states face tighter budget constraints they increasingly are pressed to rationalize expenditures on such initiatives as international business promotion, often unpopular among local politicians. Michigan's Mr. Savas notes that many states calculate the effectiveness of their overseas operations based on what the office has produced. The shift to export promotion has complicated this approach because exports are more difficult to measure and take longer to realize than direct investment, he adds.

One state that recently completed a strategic review of its international business promotion programs is California. According to state officials, Republican Gov. Pete Wilson would like to point to the actual business impact of such programs, including overseas offices, and his administration is experimenting with tools to assess this impact.

Representatives of California's World Trade Commission note that the state's Tokyo office handles 165 trade and 45 investment inquiries a month on average. Getting a handle on the value of export promotion is difficult, however, due to the concurrent efforts of other state agencies and of local chambers of commerce. Soon after Gov. Wilson was inaugurated in 1991 the state initiated a systematic effort to follow up California companies' trade inquiries. Feedback, including the value of sales achieved and key services provided by various state organizations, is being logged into a data base, which will help the state chart trends.

In addition to individual state efforts, the National Association of State Development Agencies currently is considering performance measures for overseas operations, including export dollars generated and number of contracts won. The association also is studying possible means of providing national comparability of such measures. Ms. Thomas of the National Governors' Association notes that her organization is working closely with NASDA and hopes that the latter's guidelines, anticipated by this summer, will provide a way to review state programs across-the-board. NASDA's efforts are in line with NGA's ongoing attempt to assess the current status of trade promotion programs in light of international developments and federal changes, Ms. Thomas adds.

An evaluation of Illinois' overseas offices by Blaine Liner of the Urban Institute underscores the difficulty of determining which measures most effectively assess operations.[7] Mr. Liner's study found contrasting outcomes from the business development efforts of Illinois' offices in Europe and in the Pacific Rim, a divergence he attributes to cultural differences and variations in the time it takes to develop contacts. Based on these findings he cautions against using the same test of effectiveness for overseas offices in different regions of the world.

Other Constraints on State Overseas Offices - Concurrent with state capitals' pressure on their overseas offices to accomplish more with fewer resources is a different set of constraints that some state representatives in Tokyo feel are not fully understood back home. Mr. Hayes, Kentucky's former chief representative in Tokyo, previously was posted in that state's Office of International Marketing for two years; he notes that officials in capitals like Frankfort tend to set policies and goals that are not realistic for what is going on in Japan. These difficulties include a lack of information in the state about Japan's economy, market conditions and political climate as well as such operational problems as different response times in the two capitals. Mr. Hayes says discussions with other state offices in Tokyo reveal that they all face similar problems.

Some state representatives in Tokyo have indicated that their state could benefit from a smoother relationship between the state overseas office and congressional representatives. In interviews several commented that lawmakers have failed to contact the state office when they visited Tokyo; some indicated that they would welcome the opportunity to fill legislators in on their state's Japan operations. A number also pointed out that, although their efforts are fairly well insulated from bilateral trade tensions, at times they are put in the position of explaining apparent contradictions between lawmakers' responses and the objectives of business people in the particular state that both legislators and state offices seek to represent. Several state office representatives noted that Japanese business leaders recognize that many Americans do not share the opinions voiced by lawmakers in an election year. However, a number of potential Japanese projects have been canceled or postponed due to concerns about the U.S. economy or about protectionist reactions, Michigan and Kentucky representatives reported.

Trade Promotion Efforts

Some state representatives emphasize that international trade is not a new priority for their state; a number have had in-state export promotion programs as well as overseas offices for a couple of decades. (For an earlier look at state export promotion efforts to Japan, see *JEI Report* No. 35A, September 15, 1989.) Recently, however, many states have reallocated their Japan office resources to export promotion. The State of Oklahoma's Japan office, for example, recently reversed its emphasis from investment attraction to export promotion. In 1990 it shifted to a rough split between the two tasks, and in 1991 made export promotion its primary focus.

Mr. Hemmer, the representative in Japan for Illinois, which opened its Tokyo office in 1987 primarily to concentrate on trade, sees his state as "just a little bit faster in opening up the trade aspect," but "now other states are beginning to rechannel their efforts" toward export promotion. In 1990 Japan was Illinois' largest export market after Canada; Department of Commerce estimates for that year show that the state exported $1.4 billion worth of manufactured goods to Japan. Adding Illinois' agricultural shipments greatly augments that figure, state officials say. Mr. Hemmer points to the office's success in helping Illinois companies participate in trade shows and pinpoint niche markets in Japan for their products and services; he estimates that between FY 1988 and FY 1991 Illinois companies earned $1.5 million in floor sales and $27 million in first-year sales as a result of their participation in trade shows in Japan.

In addition to identifying export opportunities and alerting business people to upcoming trade shows, the Illinois Tokyo office provides local firms with background information about Japanese companies and markets, as well as translation and other services. Mr. Hemmer emphasizes that his office is in Japan to help address problems Illinois businesses might encounter. He stresses that it is critical for companies to come to Japan to explore markets there. Mr. Yamashita, director of South Carolina's Far East Office, concurs that American firms could break into Japanese markets more successfully by visiting Japan to conduct research and to learn how to tailor their products to consumer needs there.[8] Although South Carolina's Tokyo office, which opened in 1983, is not heavily involved in export promotion, Mr. Yamashita points to one South Carolina firm that, with Japanese government assistance, adjusted its operations to better suit its products to the Japanese market. South Carolina's Ducane Co., which produces furnaces and gas grills, adopted a number of Japanese manufacturing techniques to improve quality and cost control.

In 1991 South Carolina exported $272.8 million worth of goods to Japan, its second-largest trading partner, according to Department of Commerce estimates. The top three exports combined — paper and related products, rubber and allied products, and chemicals — represented more than half of South Carolina's exports to Japan last year. The type of merchandise exported by a particular state factors into that state's trade promotion activities. Trade associations, which often have their own offices overseas, typically take the lead on overseas promotion of agricultural and industrial inputs, while state export expansion efforts generally focus on value-added manufactured goods.

Certain states also recognize the limits of their export capabilities. Instead of targeting product shipments, for example, the former head of Maryland's office in Tokyo hopes to interest Japanese pharmaceutical companies in joining forces with Maryland's numerous biotechnology firms and medical institutions.

U.S. Government's Role

Several federal as well as state programs are available to small and medium-sized companies interested in exporting to Japan. In 1990 the Department of Commerce established the Japan Export Promotion Program, geared specifically toward helping exporters access Japan's markets. A central part of that program, the Japan Export Information Center, provides business counseling and a wide range of information related to doing business with Japan.

Federal Support for U.S. Exporters - The Department of Commerce's International Trade Administration heads up the federal government's overall export promotion efforts. It has 47 district offices and 20 branch offices throughout the United States to assist American firms. These offices offer support in such areas as: export counseling, targeting overseas partners and markets, and finding financial aid. In addition, ITA's U.S. and Foreign Commercial Service has overseas posts in 68 countries to provide American firms with assistance in background information, market research, counseling and similar services. Many USFCS district offices work closely with state economic development agencies. The overseas posts also interact with the state overseas offices, although this contact generally is not as coordinated as the district offices' relationships with agencies in the states.

In mid-1990 the Bush administration announced a new initiative aimed at encouraging American businesses to expand their exports. Under the Commercial Opportunities Initiative the White House called for a Trade Promotion Coordinating Committee to increase the effectiveness of federal programs serving U.S. exporters (see *JEI Report* No. 22B, June 8, 1990). That year the USFCS conducted a strategic review of federal and state export promotion policies. As a result of its review, the USFCS launched a new effort last November to reinforce Washington's ties to state economic development agencies as well as to trade associations and various state world trade centers. The mission of the new Office of Public and Private Programs involves examining aspects of the federal-state partnership in trade assistance and seeking to coordinate initiatives in this area. The USFCS also drew up a priority list of private-sector needs the Commerce Department is in the best position to meet. These steps to focus federal government programs mirror some state actions to streamline international business development efforts, but they also have resulted in the transfer of certain responsibilities to the states.

Other Efforts to Aid Exporters - Federal export financing efforts include those of the Export-Import Bank of the United States. The bank has several loan, loan guarantee and insurance programs aimed at facilitating American exports, but it primarily finances sales of U.S. goods to developing countries. Other assistance in the form of export counseling and financial help is available to small business exporters from the Small Business Administration. Also geared to small exporters are state financing programs. Seven states have export finance programs; others will assist firms in seeking federal financing.

Japanese Government Initiatives

The Japanese government also has supported certain initiatives aimed at boosting U.S. imports into Japan. Low-interest financing for Japanese importers and foreign exporters is available from the Export-Import Bank of Japan. Although the bank has had a lending program in place since 1990 for foreign exporters or manufacturers seeking to boost their sales in Japan, the first such agreement was signed this March (see *JEI Report* No. 16B, April 24, 1992). Since 1984 the Japan Development Bank, which helps finance industrial development and infrastructure in Japan, has offered loans specifically for foreign-affiliated manufacturing operations in Japan and for foreign companies interested in investing in facilities — such as inspection, distribution or display sites — to expand exports to Japan. For example, this past December JDB made a ¥550 million ($4.1 million at ¥135=$1.00) loan commitment to General Motors Japan, Ltd. to cover one-third of the cost of construction of its Asian Technical Center in Tokyo. The recently opened center will be used to test, inspect and tailor automotive components to Japanese makers' standards and specifications. In addition, the Ministry of International Trade and Industry is backing a bill that over the next few years would establish 10 foreign access zones, or bonded warehouse facilities, near airports and harbors to improve Japan's import infrastructure and streamline customs procedures.

In 1990 JETRO launched an import expansion effort encompassing four key measures: sending private-sector merchandising and distribution experts abroad in search of potential imports; distributing program information in Japan and overseas; exchanging trade missions; and inviting foreign business representatives to Japan. JETRO officials estimate that the organization's programs facilitated roughly $100 million in additional American exports to Japan in 1991.

JETRO's plan to send 25 "export promotion advisers" overseas was launched in August 1990; 15 of these experts were chosen for roughly two-year assignments in the United States to conduct research, target promising exports and provide support for U.S. firms interested in exporting to Japan. JETRO's plans also included the dispatch to Europe and North America of 50 merchandise experts on one- to two-month import-finding missions. In addition, JETRO has signed trade promotion agreements directly with several states, including Indiana and Ohio.

While some states cite success with certain Japanese government import promotion programs, others are less enthusiastic. Several state representatives in Tokyo report that the loan programs run by Japan's Ex-Im Bank and JDB are not suited to the small or midsized companies their offices are trying to assist. Some also express skepticism about the proposed foreign access zones. Eugene Tsuji, director of the State of Mississippi's Japan Office, notes that the zones are an excellent idea but questions whether the rural locations under consideration would be practical for companies that need easy access to Tokyo.[9] Some states also criticize JETRO for being out of touch with the realities and the priorities of state government operations. Yet others cite success with JETRO's long-term trade specialist program, noting that JETRO experts have helped plug local companies into its other programs. South Carolina's Mr. Yamashita says JETRO is "doing a bang-up job" devising plans and ideas for American businesses.

Outlook

State involvement in international business promotion is a natural response to the increasingly global economy. At the same time that state leaders are reviewing their trade promotion programs they are assessing cooperative possibilities with the federal government not only in promotion but in the policy arena as well. This past February the National Governors' Association adopted a policy statement calling on Congress and the executive branch "to work with states to establish clear principles for state participation within constitutional confines in the adjudication of international trade disputes that call into question state laws and practices" and to "work toward establishing and funding a formal mechanism for including states on a routine and ongoing basis in trade policy matters."[10]

The federal government has jurisdiction over most policy decisions regarding foreign relations, including negotiating and implementing trade rules. In the course of negotiating international trade agreements Washington is obligated to confer with state and city leaders through the Intergovernmental Policy Advisory Committee. NGA's Ms. Thomas emphasizes that although this advisory role has been positive, it is no longer adequate. State leaders are concerned about the impact of existing and anticipated multilateral trade agreements on state statutes, procedures and administrative responsibilities. State laws already have been targeted in trade disputes, the NGA representative notes. This spring a General Agreement on Tariffs and Trade panel upheld a Canadian complaint alleging discriminatory practices in 40 states that impact foreign beer and wine sales.

NGA officials point out that citations of state law in trade disputes "are likely to continue as traditionally domestic policy areas, such as services regulations, government procurement, and subsidies, come under international rules." Among the policies state leaders fear may be jeopardized by new trade rules are environmental standards that are stricter than federal requirements and economic development programs that favor in-state companies, the NGA's Ms. Thomas says.

Overseas offices, affected by developments in state capitals as well as in the international arena, are certain to see more changes. In Tokyo state offices are expected to continue their recent concentration on export promotion, at least in the short term. As state leaders reassess their international development strategies, efforts to reallocate scarce resources to fit new economic realities are likely to be reflected in the role of state offices in Japan and elsewhere.

For further information, contact **Margo Grimm**.

Notes

[1] Gov. Tommy Thompson, "A Governor's Perspective on Trade," *Business America*, May 6, 1991, p. 13.

[2] Telephone interview with Jody Thomas, director, National Governors' Association Committee on International Trade and Foreign Relations, Washington, D.C., March 24, 1992.

[3] Interview with Jack Savas, managing director, Japan Operations, State of Michigan, Tokyo, Japan, March 11, 1992.

[4] Interview with Michael Hayes, former chief representative, Far East Representative Office, Commonwealth of Kentucky, Tokyo, Japan, March 19, 1992.

[5] Interview with John Hemmer, representative and managing director, Japan Operations, State of Illinois, Tokyo, Japan, March 17, 1992.

[6] Jerry Levine, *Going Global: A Strategy for Regional Cooperation* (Western Governors' Association, July 1989), p. 94.

[7] Telephone interview with Blaine Liner, The Urban Institute, Washington, D.C., May 6, 1992.

[8] Interview with Jack Yamashita, director, Far East Office, State of South Carolina, Tokyo, Japan, March 16, 1992.

[9] Interview with Eugene Tsuji, director, Japan Office, State of Mississippi, Tokyo, Japan, March 12, 1992.

[10] "Government Meeting Calls for Greater State Role in Implementing Trade Policy," *Inside U.S. Trade*, February 7, 1992, p. 17.

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Japan's Balance Of Payments Rises Sharply

A Japanese official who just has had a glance at his country's latest current account statistics might not buy the American conventional wisdom that every cloud has a silver lining. The figures for the January-March 1992 period were close to an unmitigated disaster given the official Japanese assumption that tranquil trade relations with major trading partners require a substantial and continuous reduction in Japan's huge current account surplus. That imbalance jumped 167.5 percent in this year's first quarter from the same period of 1991, hitting $27.4 billion (see Table 1). The news was equally dreary from the same perspective for FY 1991, which ended with the January-March quarter. Japan's current account surplus equaled $90 billion for the fiscal year as a whole. By comparison, the government's December 1990 economic outlook put the FY 1991 current account surplus at $30 billion, a number that was upped to $72.5 billion last December.

The first quarter's black ink was not quite as bad as it appeared. The big year-to-year change in the current account figure resulted in part from a large Japanese contribution last year to the multilateral forces that defeated Iraq in the Persian Gulf War. However, even without the $8.4 billion drop in net outbound transfers that reflected this fact, the current account still would have climbed 84.5 percent.

Economists offer assurances that current account surpluses by definition carry a silver lining in the form of outbound capital flows that ease interest rates in the rest of the world. The excess of receipts from sales abroad of goods and services and inbound unilateral transfers over expenditures for the same transactions (the current account) represents, in effect, funds that Japanese investors have lent to foreigners or invested overseas. For this reason the net capital flow always is equal to the current account. However, the hypothetical official described above would have difficulty finding this

Table 1: **Japan's Balance of Payments**

(in millions of dollars)

		Trade Balance	Exports (f.o.b.)	Imports (f.o.b.)	Services (net)	Current Account Balance	Long-Term Capital (net)
1987		$96,386	$224,605	$128,219	$-5,702	$87,015	$-136,532
1988		95,012	259,765	164,753	-11,263	79,631	-130,930
1989		76,917	269,570	192,653	-15,526	57,157	-89,246
1990		63,528	280,374	216,846	-22,292	35,761	-43,586
1991		103,044	306,557	203,513	-17,660	72,901	37,057
1989:	I	21,311	66,945	45,634	-3,595	16,064	-5,612
	II	19,794	66,560	46,766	-4,892	14,283	-30,801
	III	19,770	68,157	48,387	-4,023	14,957	-21,559
	IV	16,042	67,908	51,866	-3,016	11,853	-31,274
1990:	I	14,393	65,460	51,067	-701	12,305	-16,086
	II	13,614	65,510	51,896	-5,279	7,892	-18,985
	III	17,149	70,500	53,351	-8,045	7,400	-7,247
	IV	18,372	78,904	60,532	-8,267	8,164	-1,268
1991:	I	20,729	74,978	54,249	-920	10,260	10,707
	II	23,352	71,990	48,638	-4,064	18,664	-7,103
	III	27,745	76,934	49,189	-6,735	19,604	30,843
	IV	31,218	82,655	51,437	-5,941	24,373	2,610
1992:	I (p)	31,127	80,213	49,086	-2,498	27,443	14,077

solace in the latest statistics. Japan experienced a $14.1 billion net long-term capital inflow during 1992's first quarter, up from $10.7 billion the year before. A net capital inflow of any size in connection with Japan's current account surplus, let alone one that appears to grow along with the imbalance, would appear to make liars of economists.

Such a conclusion would be too hasty. Although well-hidden, a capital-outflow silver lining can be found in the detailed statistics. Where it cannot be found is among the data on securities transactions shown in Table 2. In the January-March period net Japanese purchases of foreign bonds declined 69.9 percent to $4 billion. In addition, Japanese investors reduced their relatively small holdings of foreign equities by $4 billion, thereby reversing in one quarter 1991's entire net stock purchases. Consequently, $1.4 billion in yen-denominated bonds was the margin by which Japanese investors were net purchasers of foreign securities in the January-March period. This relatively small outflow was overwhelmed, however, by $14.2 billion in foreign purchases of Japanese stocks, bonds and external bonds issued by Japanese companies outside the country. That led to a $12.7 billion net capital inflow into Japan involving securities transactions.

As in other recent quarters, capital flows other than those involving securities explained the apparent discrepancy between Japan's large — and growing — current account surplus and capital flows. (For a discussion of this phenomenon in the context of the 1991 current account statistics, see *JEI Report* No. 7B, February 21, 1992.) As they have in every quarter since October-December 1990, large Japanese banks reduced their outstanding net foreign borrowing in the first three months of this year, an action that is arithmetically equivalent to a capital outflow. In the January-March time frame

Table 2: **Japan's Net International Long-Term Securities Transactions**

(in millions of dollars)

		Net Japanese Purchases			Net Foreign Purchases			Net Outflow
		Bonds	Stocks	Other*	Bonds	Stocks	Other**	
1987		$-72,885	$-16,874	$2,002	$6,675	$-42,835	$30,079	$-93,838
1988		-85,812	-2,993	1,856	-21,628	6,810	35,116	-66,651
1989		-94,083	-17,887	-1,208	2,400	6,998	75,746	-28,034
1990		-28,961	-6,256	-4,464	16,991	-13,276	30,938	-5,028
1991		-68,202	-3,630	-2,474	21,241	46,779	47,264	40,978
1989:	I	-14,003	104	577	-1,646	9,004	16,212	10,248
	II	-25,091	-6,108	-776	-587	-6,196	27,501	-11,257
	III	-25,871	-4,795	722	5,403	757	14,123	-9,661
	IV	-29,118	-7,088	-1,731	-770	3,433	17,910	-17,364
1990:	I	-869	-4,946	717	6,182	-11,713	8,246	-2,383
	II	-9,353	-2,153	-954	4,975	838	723	-5,924
	III	-10,905	-459	-2,405	4,790	-3,380	10,485	-1,874
	IV	-7,834	1,302	-1,822	1,044	979	11,484	5,153
1991:	I	-13,356	463	-1,348	1,418	17,486	9,129	13,792
	II	-22,423	-2,840	-1,353	6,348	4,140	11,778	-4,350
	III	-11,120	-134	-94	9,508	15,245	13,317	26,722
	IV	-21,303	-1,119	321	3,967	9,908	13,040	4,814
1992:	I (p)	-4,021	3,975	-1,443	3,542	7,461	3,145	12,659

*Yen-denominated bonds issued in Japan.
**Bonds issued outside of Japan by Japanese institutions.

Note: For outflows a minus sign indicates an increase in assets abroad. For inflows a positive value indicates an increase in Japanese liabilities to foreigners.

net liabilities fell $43.8 billion, a movement large enough to cover both the current account surplus and the capital inflow. On March 31 net liabilities were down 51.6 percent from their year-earlier level.

Together, the increase in the current account, the drop in overseas securities purchases, the large inflow of foreign funds to purchase securities and the continuing reduction in Japanese banks' overseas liabilities form a consistent pattern — one that reflects the stormy weather the Japanese economy faces. During this year's first quarter industrial production slumped, leading to smaller imports and the larger current account surplus. Partly as a result of weak economic indicators, Japanese analysts became much more pessimistic concerning Japan's economy in 1992. That outlook shared some of the responsibility for the renewed downward pressure on Tokyo Stock Exchange share prices. The low equity prices attracted foreign buyers, but weakened the position of Japanese investors, particularly financial institutions, forcing some curtailment not only of foreign securities purchases but overseas bank borrowing as well.

A recent Organization for Economic Cooperation and Development forecast suggested that the storm clouds hovering over Japan's economy are unlikely to lift in the near term. The economy is expected to grow 1.8 percent in real terms in calendar 1992, matching exactly the 24-nation OECD average. This performance, while as good as that of most other major industrial countries, would be the worst for Japan since the first oil shock in 1974. Despite the recent torrent of bad economic news coming out of Japan, growth as low as the OECD predicted may not be fully anticipated by Japanese investors influenced by the more optimistic forecasts of domestic analysts. Japanese investors could become even more cautious if economic developments continue to point toward the correctness of the OECD forecast. That anticipated hesitancy suggests that inbound and outbound capital flows will maintain recent patterns until the bad news either is fully assimilated or is offset by evidence of an economic upturn — an event many experts believe could come later this year.

If the OECD is right and Japan and its industrial-nation trading partners grow at roughly the same rate in 1992, imports are likely to expand at roughly the same pace as exports. Perhaps for this reason, OECD analysts projected a relatively moderate increase in Japan's current account surplus this year to $92.4 billion from $72.9 billion. That figure would set a record on a dollar-denominated basis. However, by the time Japan's full-year current account statistics are released next February, the hypothetical official described at the beginning probably will be able to find a silver lining in signs of an economic turnaround leading to higher imports, a smaller surplus and increased investor confidence.

Douglas Ostrom

Quayle's Visit Steadies Relations

Vice President Dan Quayle flew to Japan May 12 primarily to take part in ceremonies commemorating the 20th anniversary of the reversion of Okinawa to Japanese rule. But his trip also had another purpose: to steady a bilateral relationship that has been strained recently. Focusing on shared values and goals, Mr. Quayle reiterated to his hosts and to the world that Japan and the United States remain strong allies and partners. The vice president's trip yielded concrete benefits in the form of a bilateral technology-sharing initiative and a Japanese commitment to contribute to the economic reconstruction of Eastern Europe. All was not sweetness and light, however. According to press reports, Mr. Quayle discussed several contentious issues with his hosts behind closed doors.

In sharp and intentional contrast to President Bush's January visit to Japan (see *JEI Report* No. 2B, January 17, 1992), the vice president hoped to "emphasize the positive" and "underscore the importance" of the bilateral relationship. Conversely, he wanted to avoid "public bickering" and "haranguing" Japan on issues of disagreement. Mr. Quayle did promise, however, that he would be direct and candid on these issues in private talks. His four-day itinerary included talks with Prime Minister Kiichi Miyazawa, cabinet ministers, leaders of the ruling Liberal Democratic Party and top business executives. It culminated in the May 15 Okinawa reversion celebration.

Prime Minister Miyazawa thanked the vice president and the Bush administration for resisting protectionist elements in the United States and for "bashing the Japan-bashers and revising the revisionists," according to the Ministry of Foreign Affairs. Instead of concentrating on divisive trade issues, the two government leaders discussed a broad range of global issues on which bilateral cooperation could have a positive impact, such as environmental problems. Mr. Miyazawa and Mr. Quayle agreed that the successful conclusion of the Uruguay Round of multilateral trade negotiations was a top priority for both Tokyo and Washington. The vice president pledged that the United States would remain engaged in Asia and would continue to station American forces in Japan as long as they were welcomed.

The first concrete results of the vice president's trip were announced May 14 when he and Minister of International Trade and Industry Kozo Watanabe inked an accord to promote the transfer of manufacturing technologies from Japan to the United States. The Manufacturing Technology Initiative will open the doors of Japanese plants to as many as 200 American engineers and supervisors a year to give them a first-hand look at Japan's manufacturing know-how. While all the details have

House Republicans also have complained that Democratic leaders introduced the trade package without consulting adequately with them. Some observers doubt that the bill's proponents will succeed in securing sufficient Republican support to override an anticipated presidential veto. For the time being Senate Democratic trade leaders appear satisfied to let their House counterparts wrestle with the trade initiative. That chamber is not expected to introduce its version of a comprehensive trade bill until the House has completed work on HR 5100.

Margo Grimm

Commerce Issues Dumping Finding On Minivans

A year ago the Big Three automotive makers took their best shot at what they long have viewed as pervasive unfair U.S. pricing of made-in-Japan cars and light trucks, formally charging Japanese manufacturers with selling minivans here at prices substantially below those charged at home (see *JEI Report* No. 23B, June 21, 1991). Chrysler Corp., Ford Motor Co. and General Motors Corp. hit their mark, but the political and public relations score was not as high as they had expected. On May 19 the Department of Commerce announced that Toyota Motor Corp. had underpriced its Previa minivan to American distributors and dealers by an average of 6.75 percent between December 1, 1990 and May 31, 1991 — the day the U.S. industry filed its antidumping petition, while Mazda Motor Corp. had sold its minivan entry, the MPV, at prices averaging 12.7 percent less than fair-market value during the October 1990-May 1991 period.

These final dumping margins admittedly are bigger than the preliminary ones calculated late last year (0.95 percent for Toyota and 7.19 percent for Mazda). Nonetheless, the pricing discrepancy on the Previa barely falls within the "conservative" dumping range of 5.4 percent to 30.5 percent estimated by Detroit and the difference on the MPV is smaller than the predicted 14.8 percent minimum gap. The relatively limited size of the dumping margins is all the more notable given the fact that Commerce investigators based Toyota and Mazda home market prices on constructed value. This methodology, used because almost all minivan sales in Japan by both companies occurred at prices lower than production costs, adds 8 percent of combined manufacturing costs and general expenses as profit if actual profits are less than this statutory amount.

Ignoring the comparatively narrow dumping margins found, U.S. motor vehicle industry representatives and automotive-state legislators on Capitol Hill hailed the Commerce ruling as a vindication of their belief that Japanese car and light truck manufacturers have used predatory pricing to make deep inroads in the American market. The Big Three drew particular satisfaction from the results of Commerce's in-depth look at the pricing practices employed by component suppliers owned wholly or in part by Toyota. This examination revealed that the automaker systematically pays less for parts manufactured by affiliated companies than an unrelated customer does and, moreover, that Toyota routinely is able to negotiate a better deal with its related suppliers for Previa parts than for components going into the Estima, the Japanese version of the Toyota minivan. U.S. industry executives have complained for years that Japanese automakers unfairly cut the costs of producing vehicles for export by forcing parts suppliers that belong to the same industrial grouping or *keiretsu* to give them substantial price breaks.

Commerce's ruling and the unfair trader label it pinned on Toyota and Mazda angered executives of the two companies. Still, they hope to avoid penalty tariffs on the Previa and the MPV as well as the pricing unknowns and administrative headaches that accompany an antidumping-duty order by convincing the International Trade Commission that the pricing of Japanese-made minivans has not hurt Detroit. A wide range of objective factors would seem to favor the Japanese competitors. Most notably perhaps, Chrysler, Ford and GM recently have regained part of the ground they lost after Mazda and Toyota entered the U.S. minivan market in 1989, upping their combined share of the expanding market to 91.6 percent in the first four months of this year from 1991's low of 88 percent (see Table).

U.S. Sales of Minivans, 1988-92

(in units)

	1988	1989	1990	1991	Four Months 1991	Four Months 1992
Plymouth Voyager	192,273	184,943	171,527	173,373	53,300	62,934
Dodge Caravan	210,918	206,426	195,276	207,919	65,625	78,253
Dodge Caravan C/V	19,222	13,150	10,680	8,591	3,573	2,725
Chrysler Town & Country	0	1,812	2,891	5,236	1,235	3,967
Ford Aerostar	184,578	188,130	177,860	147,373	44,387	52,850
Chevrolet Astro	156,833	143,941	121,168	105,808	33,998	36,539
Chevrolet Lumina APV	0	9,776	63,141	48,117	13,750	15,562
Pontiac Trans Sport	0	3,226	29,875	23,682	6,556	9,927
Oldsmobile Silhouette	0	2,122	26,075	19,003	5,126	5,553
GMC Safari	33,168	31,681	34,300	33,600	9,652	12,289
American Nameplates	796,992	785,207	832,793	772,702	237,202	280,599
Mazda MPV	n.a.	32,277	43,147	48,144	15,072	10,284
Mitsubishi Van	n.a.	910	739	59	51	2
Nissan Axxess and Van	n.a.	13,185	7,877	340	250	0
Toyota Previa and Van	n.a.	10,075	42,431	52,099	16,809	14,928
Japanese Nameplates	n.a.	56,447	94,194	100,642	32,182	25,214
VW Vanogan	n.a.	5,147	6,643	5,035	1,660	444
Total Sales	818,741	846,801	933,630	878,379	271,044	306,257
American Market Share	97.3%	92.7%	89.2%	88.0%	87.5%	91.6%
Japanese Market Share	n.a.	6.7%	10.1%	11.5%	11.9%	8.2%

Source: *Automotive News*

Although recent sales, market share patterns, profitability and other economic indicators make a seemingly strong case for a negative injury finding, the ITC's decision — due by early July — is a hard call. For one thing, three of the six commissioners are relative newcomers with skimpy voting records on antidumping proceedings. Moreover, the minivan case is on the cutting edge of the most politicized issue in U.S.-Japan relations, automotive trade and the big inroads Japan's car and light truck manufacturers have made in the American market compared with the marginal share of the Japanese market captured by U.S. motor vehicle makers (see preceding article). That could tilt the ITC decision toward injury or, more likely, the possibility of future damage to the Big Three.

A number of industry analysts speculate that if Chrysler, Ford and GM do win an affirmative ITC determination they will file an unfair pricing complaint against Japanese-made luxury cars — a candidate for Detroit's first-ever antidumping petition before losing out to minivans — or other imported vehicles. That scenario might not materialize simply because the U.S. industry already has achieved a big part of what it was trying to accomplish by going the trade-complaint route: getting Japanese automotive makers to raise their U.S. car and light truck prices again to give the Big Three more maneuvering room. Toyota and Mazda have implemented significant price increases on their minivans over the last year, with the entry-level Previa now 19.2 percent more expensive and the lowest-priced MPV up 10.7 percent. Both of these companies as well as Honda Motor Co., Ltd. and

Nissan Motor Co., Ltd. also have boosted the sticker prices on their cars by as much as $1,000-plus on a sales-weighted basis since the start of the 1992 model year. Those markups, plus the recent cut in the quota on U.S.-bound car exports (see *JEI Report* No. 12B, March 27, 1992) and the 25 percent import duty on many Japanese-made light trucks, should rein in U.S. sales of Japanese-badged vehicles even in an expanding market.

Susan MacKnight

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The views expressed in this report are those of the authors and do not necessarily represent those of the Japan Economic Institute.

JEI Report will not be published May 29, 1992 because of the Memorial Day holiday. The next issue will be dated June 5, 1992.

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JEI

REPORT

A Two-Part Report: A and B

NO. 21B
June 5, 1992

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Poor Profits Slow Start Of New Economic Plan

An advisory panel to Prime Minister Kiichi Miyazawa projected at the end of May that Japan's gross national product will expand 3.5 percent a year between FY 1992 and FY 1996 after adjusting for inflation. Given the economy's excellent track record, this forecast at first glance might seem conservative. The growing number of domestic firms reporting reduced profits for the first quarter of this year and all of FY 1991, however, shows that the projection may not be too far out of line.

The Economic Council laid out May 29 the basic outlines of its five-year economic outlook in preparation for submitting a detailed report later in June. The panel of top business leaders and academics scaled back from the previous outlook most growth figures for the five years ending March 31, 1997 (see Table). Of particular interest are the council's expectations for the balance between domestic and external demand. In the previous FY 1988-FY 1992 plan domestic demand was projected to account for 4.25 percent of total real growth, while external demand was expected to reduce growth by 0.5 percentage point, yielding a final demand figure of 3.75 percent. In the new outlook demand from overseas markets is expected to reduce net GNP growth by only 0.25 point. It is interesting to note that of the council's projections for the FY 1988-FY 1992 period, only the one for external demand was right on the money.

As for price stability the council's new plan is less optimistic than the old one. Inflation at both the wholesale and the consumer levels is pegged at levels higher than in the previous plan. The

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Economic Council's Five-Year Economic Projection

(annual averages)

	New Plan FY 1992-FY 1996	Previous Plan FY 1988-FY 1992	Actual Performance
Change in Real GNP	3.5%	3.75%	5.4%*
of which: Domestic Demand	3.75	4.25	5.9*
Change in Nominal GNP	5.0	4.75	7.0*
Consumer Price Index	2.0	1.5	2.4**
Wholesale Price Index	0.25	0.0	0.9**
Unemployment Rate	2.25	2.5	2.1***

*FY 1988-FY 1990
**FY 1988-FY 1991
***FY 1991

Source: Economic Council

relatively poor match between the previous outlook's projections and actual inflation prompted the advisory body to up its forecast on prices. At the same time, though, the council cut its unemployment prediction compared to the previous outlook. That might reflect the expected gradual shrinking of the country's working-age population starting about 1995, but the revision also could reflect optimism on the economy.

One factor explaining why the economy surpassed the council's real growth forecast for the FY 1988-FY 1992 period was exceptionally strong corporate spending on plant and equipment. Private capital spending is tied directly to corporate profitability, a point being driven home by recent announcements of company financial results for FY 1991. Spokesmen for practically every publicly traded company that closes its books March 31 blamed the economic slowdown at home and abroad for the erosion of sales and profits while noting scaled-back plans for plant and equipment investment.

Among selected financial results were:

- Six of the 11 Japanese motor vehicle makers reported lower pretax and net profits for FY 1991, despite some sales gains. Mazda Motor Corp. posted the largest drop in net profits (-65.7 percent), followed by Nissan Diesel Motor Co., Ltd. (-53.8 percent), Daihatsu Motor Co., Ltd. (-47.9 percent), Hino Motors, Ltd. (-41.4 percent), Nissan Motor Co., Ltd. (-30.7 percent) and Honda Motor Co., Ltd. (-30.2 percent). Of those motor vehicle makers reporting March 31 results, only Mitsubishi Motors Corp. posted sales and profit gains (10.4 percent and 7.2 percent, respectively).

- Japan's five integrated steel companies, hurt by the slowdown in the automotive and construction industries, reported only small changes in sales but big changes in pretax and net profits. While pretax profits were off 15.5 percent to 46.5 percent among the five firms, three with diversified business operations reported net profit gains of 24.7 percent (Kobe Steel Co., Ltd.) to 53.8 percent (NKK Corp.).

- The top six trading companies cited lower trading volumes, the yen's appreciation against the dollar and lower crude oil prices as the main reasons for declines in both sales and profits. Sales were off by 0.4 percent to 17.2 percent, while net profit declines ranged from 18.7 percent (Nissho Iwai Corp.) to 67 percent (Marubeni Corp.).

- Shipbuilders were a rare bright spot in the profit picture, capitalizing on resurgent orders for bottoms but hurt by diversified operations. Hitachi Zosen Corp., for example, will pay its first dividend in seven years thanks to orders for large tankers and waste carriers. Mitsui Engineering & Shipbuilding Co., Ltd. was the lone company in the group to report a net profit drop, mainly because it covered the bad loans of its financial subsidiary.

- Five of seven big chemical producers reported sharp drops in profits (36.4 percent to 71.2 percent) for FY 1991 because of intense price competition in plastics and weak demand for cars, appliances and construction materials.

- The domestic economic slowdown directly affected foreign travel and airfreight loads to the detriment of airline profits. On an unconsolidated basis Japan Airlines Co., Ltd. reported lower revenues from international passenger and cargo flights as well as domestic freight. A 5.6 percent gain for domestic passenger travel was not enough to prevent pretax and net losses for the fiscal year. All Nippon Airways Co., Ltd. posted pretax and net losses, while Japan Air System Co., Ltd. reported a pretax loss but a net profit gain.

- While Nippon Telegraph and Telephone Corp., a former government monopoly, reported profit declines (see note in this issue), two of the three "new" domestic common carriers, DDI Corp. and Japan Telecom Inc., reported double-digit jumps in revenues and profits. The third, Teleway Japan Corp., remained in the red for the second year in a row.

- The banking sector's profit picture was uniformly gloomy (see *JEI Report* No. 17B, May 1, 1992). The 11 nationwide commercial banks as a group reported a 14 percent fall in pretax profits mainly due to a 51.2 percent plunge in the value of their stock assets. The three long-term credit banks and seven trust banks also blamed the stock market slump for sharply lower profits.

- While operating revenues generally were up for six top consumer credit firms, their net profits were lower after they boosted reserves for bad loans in anticipation of problems linked to the end of stock and real estate speculation.

- Securities brokers reported dismal revenue and profit figures due to stagnant equities trading as well as fines and suit settlements resulting from ethically questionable trading practices.

The cumulative effect of these negative profit reports is expected to depress business investment over the near term. In turn, the expected poor performance of this pillar of growth is projecting a cloud over the economy's prospects for FY 1992. Not all government ministries or forecasters expect a poor showing, however. The Economic Planning Agency continues to make positive statements that the recession is bottoming out. Conversely, the Ministry of International Trade and Industry recently told the Japanese press that the earliest advent of an upturn most likely will be at the end of this calendar year. If the pessimists are correct, the drive to achieve the Economic Council's newest five-year plan will be off to a slow start.

Jon Choy

U.N. Peacekeeping Support Bill Appears Headed For Passage

Winding up nearly six months of often contentious discussions with leading opposition party members, Prime Minister Kiichi Miyazawa appeared likely during the first week of June to secure upper house passage of legislation that would allow Japanese military personnel to participate in United Nations-sponsored peacekeeping activities. The victory may be somewhat bittersweet, however, because of back-bending concessions by the ruling Liberal Democratic Party — concessions that analysts say will render the legislation all but toothless. The United States and other allies that

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REPORT

A Two-Part Report: A and B

NO. 22A

June 12, 1992

QUALITY OF LIFE IN JAPAN: IS IT AFFLUENT OR NOT?

SUMMARY

Although Japan is ranked as one of the richest countries on a per capita national income basis, few Japanese feel that their quality of life is better than that of Americans or Europeans. When adjusted to reflect purchasing power parities, the differences in consumer prices of the respective countries, Japanese national income drops below that of the United States. Moreover, in terms of compensation for hours worked, Japanese salaried employees' hourly compensation ends up being smaller than that of their American and European counterparts since these Japanese workers typically spend more time on the job in a year than American and German workers do. A reduction of working hours to enable Japanese to have more time for leisure is being promoted by the government, labor unions and many corporate managers.

Other factors affecting the quality of life are inadequate housing and other social infrastructure, especially in the metropolitan area. The status of these structures is hardly improved despite Tokyo's current efforts to increase public works expenditures and to reform land-holding policies. Among several measures under consideration by government leaders to upgrade the social environment is one that would relocate the national capital away from the overcrowded Tokyo area.

Attitudes toward the company and toward leisure are being questioned not only by workers but by some business leaders. Many salaried workers, particularly those in large companies, so far have sacrificed their private life for the sake of the company, which, in turn, provides them with various fringe benefits. Some Japanese workers, especially in the younger generation, have begun to emphasize their desire to enjoy life in their own way, indicating more independence from the company. This younger generation's initiative, along with institutional deregulation and other reforms, could lead to fundamental changes in the employer-employee relationship and the quality of life in Japan.

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International Comparison of National Income

Although not the richest country in the world, Japan ranked in the top five in 1990 with per capita national income of $19,035. This was less than the average of Switzerland, Luxembourg, Sweden and Finland, among the developed countries, but it exceeded that of all the other industrialized economies, including the United States (see Table 1).

Table 1: **Major Industrialized Countries' Per Capita National Income**

(in dollars)

Year	1985	1989	1990
Japan	$9,033 (9,926)	$18,472 (13,008)	$19,035 (14,354)
United States	13,349 (13,349)	16,704 (16,704)	17,379 (17,379)
West Germany	7,830 (9,034)	14,864 (12,036)	17,461 (12,340)
France	7,031 (8,421)	12,752 (11,112)	15,721 (n.a.)
Great Britian	6,039 (7,897)	10,820 (10,591)	12,856 (n.a.)

Note: Figures in parentheses show purchasing power converted into dollars. The exchange rates used to derive these numbers were estimated by the Ministry of Labor using statistics from the Organization for Economic Cooperation and Development and the respective countries.

Source: Ministry of Labor

As calculated by exchange rates this comparison does not necessarily reflect the actual economic living standards of any particular nation's consumers since the exchange rate fluctuates, depending on such factors as capital flows and monetary policy. After the major industrialized nations agreed in the fall of 1985 in the Plaza Accord to promote a realignment of currencies against the dollar (see *JEI Report* No. 40A, October 21, 1988) the yen strengthened against the dollar and European currencies. The Japanese currency rose to a high of nearly ¥120=$1.00 in late 1988 but then drifted downward. By 1991 an Economic Planning Agency comparison of consumer prices on selected, similar goods and services available in various national markets showed that the yen's purchasing power was considerably lower than the exchange rate value that year.[1] Although the average exchange rate in 1991 put $1.00 equivalent to about ¥134.5, the purchasing power of Japanese consumers was estimated by the EPA survey to be ¥170.2=$1.00. EPA's 1991 comparison of consumer prices in Tokyo, New York, Hamburg, London and Paris showed that New Yorkers could buy the same or similar goods and services for 21 percent less than Tokyoites spent (see Table 2).

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Table 2: **International Comparison of Consumer Prices, 1991**

(Tokyo = 100)

	New York	Hamburg	London	Paris
Overall	79	76	92	86
Goods	79	83	87	80
Food	74	71	61	57
Durables	87	107	141	118
Clothing and Footwear	67	72	81	96
Services	82	69	99	103
Rent or Mortgage* and Related Services	57	60	91	87
Other**	73	74	91	87
Electricity	83	99***	90	88
Gas	55	64***	46	65

*Excludes land and house purchases.

**Includes utilities, transportation, communications, medical services and education.

***Dusseldorf.

Source: Economic Planning Agency and Ministry of International Trade and Industry

The Organization for Economic Cooperation and Development has adjusted per capita national income figures using the purchasing power parities of industrialized countries after taking a broad benchmark survey in 1985 in which it sampled consumer prices on about 2,000 items. In its own calculations the Japanese government made technical adjustments to the OECD figures to account for inflation in the respective countries and to bring the estimates up to date.[2] As a result, the adjusted figures indicated that Japanese per capita national income in 1990 was about $3,000 less than that in America but still exceeded that of Germany by more than $2,000. (The figures in parentheses in Table 1 are per capita national income based on purchasing power parities as estimated by the OECD and Japan's Ministry of Labor.)

Some economists have suggested that the gap between the nominal exchange rate and purchasing power parities technically would be narrowed somewhat over time because the drop in prices of imported goods eventually would contribute to a decrease in consumer prices as a whole. (For an analysis of factors entering into exchange rate changes and Japanese pricing experiences, see *JEI Report* No. 43A, November 15, 1991.) Moreover, the sudden appreciation of the yen in the late 1980s did not fully offset differences in the nominal exchange rate and purchasing power parities for a variety of reasons. For example, international capital flows — the equivalent of Japan's excess savings — remained high. This kept exchange rates and purchasing power parities from reaching equality with each other.

Consumer welfare also depends on economic structural and regulatory factors that affect productivity and efficiency. For example, given the selected items listed in Table 2, the gap in land and housing rental prices between Tokyo and New York mostly followed the extraordinarily high rise in Tokyo land prices, which will be discussed below. The price difference in footwear is considered to stem from Tokyo's protection of the domestic footwear industry. Government pricing policies also influence electricity and gas fees. Inefficiencies in the agriculture sector and the distribution system arising from government control and regulation similarly prevent a reduction in the prices of goods paid by Japanese consumers. The Large Retail Store Law, for example, until last year's amendment protected the interests of small-sized retailers over those of consumers (see *JEI Report* No. 43A, November 10, 1989).

A November 1991 survey by the Ministry of International Trade and Industry on price differentials of imported goods sold in Tokyo, New York and major European cities further pointed to inefficiencies in Japan's distribution system.[3] If there were no differences in the degree of efficiency between domestic and foreign distribution systems, exported products should be sold at a higher price in a foreign market than in the home market because of the additional transportation costs. Of 76 Japanese-manufactured goods sold in both Tokyo and New York, 17 items sold in Tokyo were more expensive than those available in New York. Conversely, of 32 American-manufactured goods, only four items sold at a higher price in New York than in Tokyo. Since more contradictions of expected pricing patterns were found among Japanese products sold in the American market than vice versa (roughly 1 in 4.5 cases compared with 1 in 8 for U.S. goods), the finding suggested that the U.S. distribution mechanism is more efficient and competitive than the Japanese system. The situation is even more striking for the pricing of 46 European-manufactured goods sold in both Tokyo and New York; 36 goods sold in Tokyo were more expensive than in New York while only seven items in New York were higher than in Tokyo.

An international comparison of productivity in various industrial sectors also seconds the view of inefficiency in Japan's agricultural, retail and wholesale sectors (see Table 3).[4] As measured by purchasing power parities in 1989, productivity per worker in the American agriculture sector was more than three times higher than that of a Japanese farmer. U.S. retail and wholesale employees ranked 1.9 times higher in productivity than their Japanese counterparts. (For a look at different evaluations of Japanese and U.S. productivity, see *JEI Report* No. 4A, January 31, 1992.) At the consumer level the relatively small difference in labor productivity between Japanese and American manufacturing workers is consistent with the gap in prices between durable consumer goods sold in Tokyo and those in New York, being not as large as the difference in food prices (Table 2).

Interestingly, in cases of monopolies, such as electric power and gas, where competition is limited and consumer prices are approved by the government based on cost plus a certain amount of profit, the Japanese power supply industry is considered much more productive than its American and European counterparts. The limited number of suppliers and the small size of the market contributes in some part to high productivity, but the ranking also could suggest that Tokyo allows energy suppliers to set relatively expensive charges in line with the government's energy security policy.

Adjusting per capita national income figures for purchasing power parities and taking into account productivity differences are still insufficient to give a complete overview of quality of life issues. When such factors as ratio of the labor force to the total population, the unemployment rate, job status, job categories or working hours are added, Japanese workers also come up short compared with American and German workers (see Table 4). Hourly compensation of productive full-time workers in the manufacturing sector in 1990, for example, shows that the average Japanese worker put in 176 more total hours than his or her American counterpart and 526 hours more than a German worker.[5] This converts to an hourly compensation of Japanese workers that is equivalent to 92 percent of American workers' nominal pay and 64 percent that of German workers. Calculated on purchasing power parities, this country's workers were paid 44 percent more per hour than their Japanese counterparts; German workers earned 47 percent more than Japanese.

In terms of job categories and the impact of taxes on take-home pay few empirical studies are available to back up the casual observations that Japanese executives are not as well off as U.S. execs. One of the analyses, a joint effort by Osaka University Professor Takao Kato and Mark Rockel of Carbon Cycle, Inc. of Maryland, indicated that the average taxable income of top businessmen in Japan, which amounted to ¥44.4 million — $186,000 at the nominal exchange rate of 1985 (¥239=$1.00) or $204,000 at the OECD-figured purchasing power parity price of 1985 (¥218=$1.00) — was less than

Table 3: **Productivity in Major Industrialized Countries Adjusted for Exchange Rates and Purchasing Power Parities**

(Japan = 100)

	United States (1989)		West Germany (1988)		France (1989)		Great Britain (1987)	
	Exchange Rate ¥138=$1.00	Purchasing Power Parity ¥204=$1.00	Exchange Rate ¥73=DM1	Purchasing Power Parity ¥85.3=DM1	Exchange Rate ¥21.6=F1	Purchasing Power Parity ¥27.3=F1	Exchange Rate ¥236=£1	Purchasing Power Parity ¥364=£1
GDP per Worker	95	141	93	108	95	120	68	105
GDP per Working Hours	109	162	119	139	116	146	n.a.	n.a.
Manufacturing Output per Worker	80	118	77	90	80	101	52	81
Manufacturing Output per Working Hours	88	130	103	120	105	132	58	90
Agriculture, Forestry and Fishery Output per Worker	212	313	95	111	153	194	123	189
Mining Output per Worker	102	151	27	32	48	60	125	193
Utilities Supply per Worker	46	68	45	53	35	44	23	35
Construction Output per Worker	68	100	73	84	67	85	62	95
Retail and Wholesale Trade Output per Worker	129	190	107	125	153	193	71	109
Transportation and Communications Output Per Worker	93	138	83	97	75	95	62	96

Source: Estimated by the Ministry of Labor using Organization for Economic Cooperation and Development data and respective countries' statistics. Cited in *Shukan Toyo Keizai*, March 28, 1992.

Table 4: **Purchasing Power of Production Workers in Major Industrialized Countries, 1990**

	Japan	United States	West Germany
Scheduled Hours Worked	1,905	1,756	1,499
Overtime Hours Worked	219	192	99
Total Hours Worked	2,124	1,948	1,598
Hourly Compensation	¥1,555	¥1,688	¥2,419
Exchange Rate*	$10.73	$11.65	$16.71
Index	100	109	156
Purchasing Power Parity Basis	100	144	147

*¥144.79=$1.00.

Source: Estimated by Ministry of Labor using respective countries' statistics. Cited in *Shukan Toyo Keizai*, March 28, 1992.

30 percent of the average income of American chief executives (estimated at $645,000 as of 1986).[6] Their study analyzed salaries of 599 chief corporate executives of major Japanese companies in 1985 and 506 American chief executive officers in 1986.

Moreover, the upper level income tax in Japan is heavier than the upper level U.S. tax rate. According to Japan's current five-bracket tax table, the marginal tax rate reaches the highest level of 50 percent for taxable income greater than ¥20 million ($148,148 at ¥135=$1.00).[7] In this country a married person filing jointly with more than $82,150 in taxable income pays a top marginal rate of 31 percent. A married person filing jointly with taxable income of $500,000, for example, would pay only $148,116 in U.S. federal income taxes but in the equivalent situation would pay $221,943 in Japanese national income taxes. Without even considering salary differentials, the after-tax comparison indicates an even larger gap between Japanese and American corporate executives.

Housing Conditions

The land speculation boom in the late 1980s drove up costs for residential and commercial land by an average 187 percent and 320 percent, respectively, based on price changes in Tokyo between 1983 and 1991. These extraordinary rises in land prices, particularly in metropolitan areas, created a huge asset gap between the haves and the have-nots. Many young Japanese living in large cities, who have no hope of inheriting land, are finding home ownership a remote possibility because of the speculation boom. On top of that, the average Tokyo apartment runs about double the charge for a New York apartment (Table 2). The consumer price index, one of the critical components from which purchasing power parities are derived, includes rents and land leases but not the cost of buying a home.

In an effort to determine what land prices might have been without the speculative bubble, the Economic Planning Agency conducted a study in which it assumed that the theoretical land price should be correlated to variations in rent and long-term interest rates.[8] The gap between the actual and the theoretical land prices had been relatively small until 1986. For example, using 1983 as a base year, the theoretical price index for commercial land in Tokyo in 1971 was 0.30 while the actual land price was 0.31. The residential land price index was measured theoretically as 0.40 and actually as 0.33 that same year. But in 1991 the theoretical land price was calculated as 2.39, or 139 percent higher than the 1983 prices, in Tokyo's commercial areas and as 1.31, or barely 31 percent higher, in the residential areas. (The actual prices were 320 percent and 187 percent higher, respectively.) EPA's analysis indicates that between 1983 and 1991 the actual increase in the cost of residential land was almost six times higher than the theoretically calculated gain.

The average house sales price in the Tokyo area — figured by the Ministry of Construction in 1988 at ¥59.3 million ($463,000 at the 1988 average rate of ¥128=$1.00) — was equivalent to 8.7 times the annual average income of a householder and family. Five years earlier the average purchasing price in Tokyo was 4.84 times the average householder's annual income. On a nationwide basis the ratio of house sales prices to the average family's income increased 4.02 times to 5.72 times during the same five-year period. In 1988 the average nationwide house sales prices was ¥35.5 million ($277,000).[9] It is worth noting that old houses are rarely traded in Japan, where a house might be torn down so that land can be sold unencumbered.

Both the average house sales price in Japan and the sales price as a percentage of annual family income exceeded the corresponding figures reported in this country. Department of Housing and Urban Development statistics for 1988 listed this country's median sales price of new privately owned single-family houses at $112,500, equivalent to 3.09 times the median annual income of families headed by a married couple.[10] The median sales price for a single-family home, including both newly built and old houses, was $89,300 that same year, according to the National Association of Realtors, or just 2.45 times an average family's annual income.[11] The median house sales price in the greater New York area (Northern New Jersey, Long Island and Connecticut) was $183,800. Since the average income in the New York area is estimated to be about 34 percent higher than the national average, it follows that the 1988 house sales price in the New York area was almost 3.8 times larger than the annual family income of an average New Yorker. In addition to this country's housing being more affordable on average, a homebuyer gets more for the price here, since the average floor space per person runs about 650 square feet — more than 2.4 times greater than the Japanese average.[12]

The jump in Japanese housing prices has meant that only a limited number of people, those with sufficient savings or other assets, can afford to buy a house. The ratio of personal funds used to buy a home in the Tokyo area increased from 50.9 percent in 1984 to 70.5 percent in 1989.[13] Despite this increase, housing loans continued to be much in demand since the absolute increase in the cost of a house exceeded the increase in personal resources. A Management and Coordination Agency survey of families who purchased a house within the previous five years suggests that families in which the householder was between 30 to 34 years old as of 1989 owed, on the average, 2.08 times their annual income on outstanding housing loans; the same figure in 1984 had been 1.99.[14]

As in this country a majority of Japanese own their own home. According to a Ministry of Labor study on home ownership ratios, 61.3 percent of Japanese families in 1988 owned their houses, slightly lower than in the United States (63.5 percent in 1985) but significantly higher than the French (50.7 percent in 1982) and the West Germans (40.1 percent in 1982).[15] The relatively high ratio of home ownership in Japan stems in some part from the fact that few rental houses of good quality are available because many potential landlords prefer to avoid being subject to the Land Lease and House Lease Laws, which very much protect tenant rights — despite a recent amendment initially drafted to soften such protection (see *JEI Report* No. 38B, October 11, 1991).

Owning a house so far has been regarded as one of the major goals of many salaried workers. In addition to benefits derived from having equity in a home, owners generally enjoy nearly a third more space in their home than renters do. A 1988 survey by the Management and Coordination Agency found that the nationwide average floor space for owned homes was 116.78 square meters (1,256 square feet) and the average in the Tokyo area was 97.21 square meters (1,045 square feet); floor space in rental houses, however, averaged nationwide at 44.27 square meters (476 square feet) and in Tokyo at 37.98 square meters (408 square feet).[16]

The Management and Coordination Agency survey also showed that more than 70 percent of salaried workers over age 45 owned their home in 1988 while barely 13.7 percent of the generation aged 30 and younger owned a house. This suggests that the average salaried worker purchases a house between the ages of 30 and 45 or so. The late 1980s speculative land boom may have been a major factor in the drop in the ownership ratio, especially among those in their 30s. Between 1983 and 1988 there was little change in the house ownership ratio for workers 45 years old and older. Among workers aged 30 to 34, however, only 36.3 percent owned a house in 1988 although 43.3 percent in that age group owned a house in 1983. For workers between the ages of 35 and 39, the ratio of ownership dropped from 58.0 percent to 54.7 percent during the same five-year period.[17]

Although those who bought their house before the early 1980s benefited from the recent hike in land prices, many younger workers living in Tokyo and other major cities — particularly those who moved from the countryside and have no expectation of inheriting land or a house from their parents — are disappointed and even frustrated by the increasing gap between the haves and the have-nots. A nationwide poll by the *Yomiuri Shimbun* in April this year indicated that only 38 percent of workers under age 29 regarded owning a house as a main goal of their life; a majority of workers over age 40, most of them already homeowners, continued to list this as a major goal.[18]

For those who have not abandoned the vision of home ownership a smaller house or a house located farther from his or her office are two ways of trying to offset the higher purchase prices. One indicator of the smaller lot sizes being purchased is that those who acquired public housing loans in 1988 bought on average 131 square meters (1,408 square feet), or 78 percent of the official standard lot size used for evaluating loan applications; the standard lot size, as calculated by earlier, actual purchases, runs about 167 square meters (1,795 square feet).[19]

A private housing developers' organization provides evidence that more new homes are being built farther from the center of Tokyo. The group's survey noted that newly built houses more than 50 kilometers (31 miles) from the center of Tokyo were only 34.5 percent of all new homes built in 1984 but formed 53.2 percent of all new 1989 houses.[20] A one-way commute for those living more than 50 kilometers from work usually takes more than one-and-a-half hours.

The commute, itself, is associated with a less-than-optimum quality of life. Most commuters in the Tokyo area use a commuter train rather than a personal car. During rush hour commuting trains often are jammed with passengers; some estimates figure passengers outnumber seats and straps by a little less than 3 to 1.[21] A newly designed commuting car, in fact, even eliminates passengers' seats. Long, crowded commutes not only reduce workers' leisure time but make them exhausted as well by the time they arrive at work or home.

Leisure and Limited Public Infrastructure

Long working hours and lengthy commutes mean that the average male salaried worker aged 40 to 60 living in the Tokyo area has only about 163 minutes of free time a day on weekdays; those living in rural areas have about 192 minutes, according to a 1986 Management and Coordination Agency survey. On weekends Tokyo-area workers spend 481 minutes a day in leisure pursuits, about an hour more than workers in the countryside.[22] The fairly recent implementation of a five-day workweek has had more widespread application in larger cities than in rural areas where the number of people engaged in time-consuming agricultural work skews general comparisons. Respondents to the survey said they spent about half their weekends watching television or listening to music, about one-fourth the time resting and the remainder on more active pursuits.

Another nationwide survey by the Management and Coordination Agency gained responses in 1988 on the use of leisure time but also asked why many salaried workers engaged in only limited outdoor activities.[23] About 38.4 percent of all respondents pointed to the scarce amount of free time on weekdays, 27.6 percent complained about too few holidays and 29.3 percent mentioned the difficulties they encounter in taking a long vacation. Also a factor for 34.2 percent of the respondents was a lack of sufficient money for leisure activities. This financial constraint most likely is related to the fact that many householders in Japan, particularly those living in the Tokyo area, have to save a significant portion of their income to eventually buy a house or to repay a housing loan on an already-purchased model.

Beyond the perception of too little money and too little time was a complaint by 13.7 percent of the respondents about the limited number of entertainment facilities. The lack of public entertainment facilities in residential areas is well-documented in Japan. Public parks, for example, provide an average space per person in Tokyo's metropolitan district as of 1990 of just 2.42 square meters (26 square feet) while a New Yorker in 1989 had 155 square feet and a Washingtonian enjoyed nearly 500 square feet, according to Ministry of Construction estimates. Publicly operated tennis courts, for which a reasonable fee is charged, made up only 32 percent of the total tennis facilities in Japan as of 1986. Public golf courses amounted in the same year to as few as 7 percent of the total.[24] Japanese wanting to cruise open highways usually found traffic congestion; Japan's super-highway road network per thousand vehicles in 1990 averaged just 88 kilometers (55 miles), while this country's equivalent figure, not considering the numbers of lanes, was 283 miles in 1988.[25] Furthermore, driving for pleasure is not cheap in Japan since tolls are charged on all Japan's super-highways and gasoline costs in Japan are about four times higher than in America.

Government Efforts to Improve Quality of Life

The government has initiated several policy measures to improve the quality of life in Japan. Following the 1989-90 Structural Impediments Initiative talks between Tokyo and Washington, the Japanese government promised to spend about ¥430 trillion ($3.2 trillion at ¥135=$1.00) on public works between FY 1991 and FY 2000; of the total, 60 percent would be allocated for improvements of life-related infrastructure, such as sewage facilities, garbage recycling centers, housing, transportation, parks, hospitals and schools (see *JEI Report* No. 39A, October 12, 1990). SII also focused on Japan's land reforms and distribution system. Tokyo has implemented a series of land-reform measures, including an introduction of a new land-holding tax and an amendment of the Land Lease and House Lease Laws. In an attempt to halt the speculation driving up prices the government also has urged that bank loans for housing be restricted (see *JEI Reports* No. 38B, October 11, 1991, and No. 5B, February 8, 1991). Although land prices have begun to moderate or, in some cases, decline, a further drop in prices remains to be seen.

Among other quality-of-life adjustments undertaken by Tokyo to rationalize the retail and wholesale trade and the distribution systems that supply them are amendments to the Large Retail Store Law and the revision of antimonopoly regulations to eliminate certain exemptions. The gap between productivity levels of Japan and the other major industrial economies in these sectors is expected to decline as the distribution system is liberalized, with commensurate reductions in prices for consumers.

The Government Administrative Reform Council in July 1991 addressed the issue of Tokyo's overcrowding problem and recommended that the central government consider transferring more power to local governments to help achieve more balanced growth in Japan's social and economic development (see *JEI Report* No. 41A, November 1, 1991). Moreover, a relocation of the national capital is under study by Diet members as well as government officials (see *JEI Report* No. 9B, March 6, 1992).

In a new five-year economic plan, being prepared under an initiative of Prime Minister Kiichi Miyazawa, the Economic Council hopes to emphasize ways to improve the quality of life in Japan. Among several proposals drafted by the advisory task force is one urging a future goal of 1,800 total working hours a year, including both scheduled and unscheduled work hours.

The Economic Council also has ideas on making housing more affordable. For example, it has suggested that the price of land with a newly built house in the Tokyo area should be within five times the annual income for salaried workers; no specific year or implementation plan has been proposed for this goal. The council also unveiled a guideline for new housing projects in the Tokyo area. Of 4.3 million houses eyed for construction in the area up to the year 2000, there would be an effort to build about half, or 2.6 million, within 30 kilometers (18.6 miles) of downtown Tokyo. Other targets, such as increased park space in urban areas, expanded access to sewage systems, easing of crowded conditions on commuting trains and increased construction of highways are also policy goals. The new economic plan, to be formally delivered in June, also is expected to urge Tokyo to proceed with the liberalization of Japan's market by implementing the measures that Tokyo agreed to in the SII talks.

Quality of Life and Company/Employee Relations

Employee attitudes toward the company are key to a review of how the Japanese value life. The evolution of work and play habits in Tokyo or other large cities corresponds to motivations linked to a company's promotion and related business practices, such as career-long employment and seniority-based pay scales. A majority of the employees hired by large corporations are recruited just after they graduate from a university or a high school. Those in the career track are expected to continue to work until they retire around age 60 or so. Instead of layoffs when a reduction in force might be considered necessary, corporate managers usually send their employees to affiliated firms. Under the seniority system, basic annual salary increases correspond to years worked and, in principle, a senior person is paid more than younger workers. Job promotions, which also are tied to the seniority-based, career-long employment system, offer higher status, but the total salary of managers or other titled officers is not very much higher than nontitled workers in the same age group. The title represents not only the degree of power or reputation in the company but social status as well. Since basically all employees at every stage of employment have the same opportunities for promotion, salaried workers — unless they give up the goal of being promoted — face severe competition from their colleagues as they climb their company's career ladder. In addition to weighing an employee's contribution to sales and profits, an employer often considers the extent of extra working hours (including weekends) to evaluate an employee's loyalty toward the company, one of the considerations for a promotion. The competition for promotions reportedly results in some workers not officially recording extra hours and working overtime without compensation.

Despite not being based on any written contract nor widely applied in many small- and medium-sized companies (especially those located outside of large cities), these expectations for promotion and seniority benefits are common among salaried workers in large companies located in large cities. A survey by Keidanren (Japan Federation of Economic Organizations) of 842 corporate executives and managers in big Japanese corporations asked whether competitive promotion practices contributed to a company's overall competitiveness.[26] Of the chairmen and presidents who responded, 73 percent said yes, while 60 percent of the managers saw merit in competition for promotion. In response to a question about what they saw as the prime motivating factor for employees, 37 percent named the job itself, 31 percent regarded the idea of a promotion as the best incentive and 27 percent pointed to the chance of improved income possibilities.

Various other incentives that companies use to retain employees and promote loyalty include tying retirement funds or pensions to the length of employment and providing fringe benefits, such as help with commuting expenses, company-owned apartments for employees, subsidies for housing expenses for employees (including housing loans at a discounted rate), and company-paid travel and entertainment facilities (like resorts or sports facilities). Employees accustomed to these company benefits do not have to worry about finding entertainment opportunities but may not have much time to spend on leisure. The benefits have some drawbacks for employees who might want to seek work elsewhere, however. A company-provided housing loan, for example, compels employees to stay in the company until the loan is paid up. If an employee borrows a large amount to buy a house, most of the repayment schedule is calculated to coincide with his or her retirement.

Large companies provide more of such fringe benefits than smaller firms. According to a Ministry of Finance survey on what companies spend for employees' welfare as a proportion of total personnel costs, companies with over ¥1 billion ($7.4 million) in capital in 1988, on average, spent 16.8 percent of personnel costs for employees' welfare, while companies with capital of less than ¥100 million ($741,000) spent only 9.3 percent.[27] A Labor Ministry survey for the same year indicated that large firms with more than 5,000 employees paid each employee five times more in retirement benefits, 12 times more for housing-related benefits and twice what companies with 30 to 99 workers paid for entertainment and sports activities for their employees.[28] (For a look at various job-related benefits in Japan, see *JEI Report* No. 40A, October 19, 1990.) Since the opportunities to be recruited by larger companies are much greater for university graduates, especially those from universities with the best reputations in Tokyo or the Osaka, Kyoto and Kobe areas, many students from rural Japan traditionally have seen benefits in moving to these large cities to study in hopes of getting work with the larger companies.

Challenges to the traditional employment patterns have begun to arise, although the movement is still small. Some workers, especially those in the younger generation, have assessed the implication of traditional employee/company relations and have put more value on their private lives than on their jobs. For these people the usual company incentives no longer are as attractive. Company-owned apartments or resorts, for example, are considered akin to being at work, since workers hardly can relax around a boss or colleagues at these facilities despite the low cost of using them. Younger workers, especially female employees, often prefer to travel abroad on their own agenda and at their own expense rather than play tennis with colleagues or golf with business customers even if the company covers these costs. Moreover, the high rise in land prices has resulted in fewer members of the younger generation expecting to own a house. Company-provided housing loans, therefore, carry fewer attractions for these workers.

As the social benefits and conditions of employment change in the eyes of the employee, the incentive to remain with the same firm throughout a career weakens. There are more indications that younger Japanese are not hesitating to change jobs if they are not satisfied. The Management and Coordination Agency's 1988 survey on the younger generation's attitudes toward work and jobs suggested that only 26.2 percent of the respondents wanted to continue in the same job, 25.3 percent would continue in the job although they sometimes felt like changing, 27.9 percent of the respondents would change employment if they had a chance, and 5.3 percent expressly wanted a new job (15.6 percent did not answer the question).[29] MCA also referred to a similar survey in this country in which 57.6 percent of young American workers said they wanted to continue in their job, 7.4 percent would continue in the job although they sometimes felt like changing, 18.5 percent would change jobs if they had a chance and 16.5 percent wanted a definite change in jobs. The actual job-changing ratio for all young male Japanese workers aged 20 to 29 in 1989 was 17.5 percent, a much lower ratio than they had expressed in the MCA survey a year earlier.[30]

Because of Japan's declining birth rate and the expected long-term shortage of younger workers, labor unions and corporate managers have begun to respond seriously to younger workers' attitudes. One common target is a reduction of working hours, although unions and managers differ on their preferred range of reduction. Some companies have introduced an additional period of paid holidays, called refreshment holidays, for employees who have worked 15 or 20 years. Flextime working hours and permission to work at home also have been introduced by some companies to let workers avoid rush-hour commuting. Some progressive companies are allowing employees to take paid leave so they can engage in volunteer activities for a certain period. Moreover, some firms have undertaken adjustments to their current payment system, which consists of a monthly fixed income and usually a bonus twice a year plus overtime compensation. By changing to a fixed annual salary these firms hope their employees will feel more free to concentrate on longer term results rather than worrying about daily work hours; as a result, the workers with annual salaries will be able to allocate their time more flexibly than ordinary workers.

Sony Corp. chairman Akio Morita recognized the importance of employer/employee relations in quality of life issues in a February 1992 article of the respected opinion magazine *Bungei Shunju*. He recommended that Japanese corporate managers review the relationship between the company and its employees by taking more account of each employee's individual values and expectations. More concretely he proposed a reduction of working hours and an increase in employee salary levels to those of their American and European counterparts (see *JEI Report* No. 17A, May 1, 1992). Since the lifestyle of Japanese workers to date has been very much linked with attitudes towards their employer, a change in corporate management is a critical factor if the quality of Japanese life is to be improved along the lines associated with other countries' advanced standard of living.

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Changes Slated For Financial Regulation In Japan

Surprising Japanese and foreign observers alike, legislation fundamentally altering Japan's financial system has avoided becoming entangled in the controversy surrounding the government's proposal to participate in United Nations peacekeeping actions. If, as expected, the financial reform bills are approved by both houses of the Diet during the current session, a new securities trading watchdog will be created in July and head-to-head competition by banks and stock brokers will begin next year. The government and ruling Liberal Democratic Party also are working on further financial system reforms that will give domestic insurance companies and nonbank financial institutions new freedom to diversify their operations.

- Investment and commercial banking regulation - The lower house of the Diet approved a 16-bill package June 5 that will allow securities brokers and banks to compete directly against each other while maintaining regulatory separation of investment and commercial banking. Like America's Glass-Steagall Act of 1934, Article 65 of Japan's Securities and Exchange Law prohibits banking and stock brokering activities under one roof. Both Washington and Tokyo have been considering modifying their prohibitions because global capital markets increasingly have become integrated and the European experience with "universal" banks (institutions that perform both commercial and investment banking functions) has proved positive. Progress, however, has been blocked in both

STATISTICAL SUPPLEMENT

Trade and Payments Data

(in millions of dollars unless otherwise indicated)

	1990	1991	January-March 1991	January-March 1992	January 1992	February 1992	March 1992
Japan's Balance of Payments							
Trade Balance	$63,528	$103,044	$20,729	$31,127*	$5,893*	$12,336*	$12,898*
Exports (f.o.b.)	280,374	306,557	74,978	80,213*	23,325*	27,421*	29,467*
Imports (f.o.b.)	216,846	203,512	54,249	49,086*	17,432*	15,085*	16,569*
Current Account Balance	35,761	72,901	10,260	27,443*	3,064*	10,798*	13,581*
Long-Term Capital (net)	-43,586	37,057	10,707	14,077*	3,515*	1,717*	8,845*
Overall Balance	-7,234	76,369	8,129	46,533	9,574	15,615	21,344
International Reserves (end of period)	77,053	68,980	69,894	68,230	68,701	68,188	68,230
Japan's Customs Clearance Trade							
Trade Balance	52,149	77,789	14,468	25,016	3,834	10,213	10,969
Exports (f.o.b.)	286,948	314,526	76,338	82,444	23,984	28,102	30,358
Cars	41,348	44,713	11,801	13,138	4,306	4,553	4,279
Steel	12,509	13,612	3,191	3,106	872	1,031	1,203
Imports (c.i.f.)	234,799	236,737	61,870	57,429	20,151	17,889	19,389
Crude Oil	31,584	30,181	10,595	6,933	2,596	2,223	2,114
Manufactured Products	118,028	120,341	29,427	29,376	10,145	9,078	10,154
Japan-U.S. Trade							
Trade Balance	37,954	38,220	9,043	9,243	2,448	3,678	3,117
Exports (f.o.b.)	90,322	91,538	22,311	22,771	6,750	7,947	8,074
Imports (c.i.f.)	52,369	53,317	13,268	13,528	4,303	4,269	4,957
Yen-Dollar Exchange Rate (average for period)	Y144.79	Y134.54	Y133.86	Y128.41	Y125.03	Y127.50	Y132.70
U.S. Trade							
Trade Balance	-101,718	-65,399	-12,739	-11,336*	-5,398	-2,240	-3,698*
Exports (f.a.s.)	393,592	421,730	102,759	111,004*	34,469	36,860	39,676*
Imports (Customs)	495,311	487,129	115,499	122,340*	39,867	39,099	43,373*
U.S.-Japan Trade							
Trade Balance	-41,105	-43,385	-10,358	-10,769*	-3,817	-2,967	-3,986*
Exports (f.a.s.)	48,580	48,125	12,332	12,430*	3,661	4,417	4,352*
Imports (Customs)	89,684	91,511	22,689	23,199*	7,477	7,384	8,338*

*Preliminary

STATISTICAL SUPPLEMENT

Japanese Economic Indicators

(percent change from year-earlier period unless otherwise indicated)

	1990	1991	January-March 1991	January-March 1992	January 1992	February 1992	March 1992
Discount Rate (end of period)	6.0%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%
Outstanding Money Supply	11.7%	3.6%	6.0%	1.7%	1.8%	1.6%	1.8%
Industrial Production	4.6%	2.1%	6.0%	-4.7%	-3.7%	-4.6%	-5.6%
Manufacturing Operating Rate	2.3%	-1.4%	2.3%	-6.4%	-5.9%	-6.5%	-6.8%
Number of Bankruptcies	-10.6%	65.8%	49.0%	39.8%	47.0%	44.8%	29.5%
Residential Construction Starts	2.7%	-19.7%	-11.4%	-8.4%	-16.4%	- 7.0%	-2.3%
Job Openings to Applications (ratio)	1.40	1.40	1.46	1.25	1.28	1.25	1.22
Nominal Wages	4.7%	3.7%	3.1%	3.6%	5.4%	1.4%	3.5%
Manufacturing Labor Productivity	4.2%	2.3%	7.8%*	-3.9%*	-3.9%	n.a.	n.a.
Wholesale Prices	2.0%	0.2%	1.6%	-1.8%	-2.2%	-1.6%	-1.4%
Consumer Prices	3.1%	3.3%	3.7%	1.9%	1.8%	2.0%	2.0%
Yen-Based Export Prices	2.1%	-3.5%	-4.0%	-2.5%	-3.9%	-2.0%	-1.7%
Yen-Based Import Prices	8.6%	-7.9%	1.1%	-13.4%	-18.2%	-12.8%	-8.7%

*Through January of each year only.

For Japan's latest GNP figures, see JEI Report No. 12B, March 27, 1992.

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REPORT

A Two-Part Report: A and B

NO. 23A **June 19, 1992**

JAPAN SEEKS NEW APPROACHES TO A POSTAPARTHEID SOUTH AFRICA

SUMMARY

For most of the international community political and economic relations with South Africa have been complicated by the explicit policies of racial separation in place there since shortly after World War II. During the last decade intensified global pressure on Pretoria to abandon its apartheid program has presented a particular challenge to the Japanese government and private sector. Japan's strong economic relationship with resource-rich South Africa became a focus of criticism during this period, culminating in 1987 when Japan became that country's top trading partner. The high priority Japan traditionally has placed on trade became a liability in the eyes of critics who charged Tokyo with enacting flimsy constraints on relations with South Africa and faulted Japanese businesses for working around these guidelines to pursue additional business opportunities in that country.

In light of South African President F.W. de Klerk's recent steps to dismantle the institutions of apartheid, Japan and other nations have begun to revise their cautionary view of South Africa. Many questions remain, however, for countries seeking a new relationship with South Africa, since leaders there still are working to establish a fully representational government for their people. Solidifying relations with the disparate forces hoping to lead South Africa will present a challenge to Tokyo and other world capitals. Political as well as economic uncertainties there also are sure to shape the approach of Japan's private sector, which is assessing the opportunities to be found in the changes in South Africa.

Overview

As Japan's international presence has expanded, an absence of historical and geographical ties has hampered close economic and political relations with Africa. The region's severe economic problems also have been a factor. While the Japanese economy relies heavily on industrial and agricultural inputs found in less developed nations, a relatively small share of Japan's growing trade and investment efforts have been devoted to Africa over the last 40 years or so. Although the oil crises of the 1970s compelled Japanese businesses to turn to the region temporarily as an alternative energy source, the expansion of Japan-Africa trade that followed was short-lived. In 1991 only 1.6 percent of Japan's total imports came from Africa. In contrast, 44 percent originated in Asia and 27 percent were sourced from North America. Moreover, only 1.9 percent of Japanese foreign direct investment in the period through March 1991 was channeled to Africa, compared with 43.8 percent to North America and 15.3 percent to Asia.

Tokyo has attempted to address some of the structural weaknesses hindering Africa's economic development through significant increases in the share and the amount of its foreign aid to the region over the past few years. Official development assistance to Africa totaled $792 million in 1990, the latest year for which country-specific aid figures are available. The outlay represented 11.4 percent of Japan's total foreign aid disbursements that year. In recent months Tokyo also has supported a potential leadership role for South Africa in the economic development of sub-Saharan Africa. Japanese leaders have framed stronger ties to Pretoria as a means of improving Japan's relations with the region and bolstering sub-Saharan stability and growth. The most industrialized economy in Africa offers a well-developed infrastructure and a sophisticated manufacturing sector as credentials for its role in serving as an engine for regional development. These assets, along with South Africa's wealth of strategic minerals, also help account for its strong trade ties with Japan.

While Japan's trade relationship with South Africa is minor in a global context, representing less than 1 percent of its combined exports and imports, in the sense that the partnership dominates Japan's trade relations with Africa, the relationship has much more significance. In 1991 Japan-South Africa trade which totaled $3.5 billion, represented 35 percent of Japan's trade with the continent. Exports to Africa ran $6.0 billion, of which South Africa bought 27 percent. Imports from the continent amounted to $3.9 billion, of which shipments from South Africa came to 47 percent. Moreover, Japan's purchase of almost 7 percent of South Africa's exports in 1990 made it that country's second-largest customer.

Steel, nonferrous metals, nonferrous metal scrap, coal, iron ore and nonmetallic mineral ores lead Japan's imports from South Africa (see Table 1). Like its global shipments, Japan's exports to South Africa are dominated by machinery and transportation equipment, including motor vehicles and electronic goods (see Table 2). Trade between Japan and South Africa expanded rapidly prior to the 1980s when criticism of Pretoria's apartheid policies began escalating worldwide. From under $200 million a year in the early 1960s two-way trade grew to nearly $643 million in 1970 and then to more than $3.5 billion in 1980. Over the next 10 years Japan-South Africa trade remained on a plateau. The level of that plateau relative to other countries' trade with South Africa represented in the eyes of some critics an inadequate response by Japanese leaders to racial discrimination in that country.

Japan's Relations with South Africa Under Apartheid

Japan's political and economic relations with South Africa long have been subject to certain restrictions. Official contacts between the two nations were limited to the consular level from the end of World War II until this past January (see *JEI Report* No. 3B, January 24, 1992). Constraining closer political ties were South Africa's apartheid policies, which, from as early as 1959, Japanese officials have criticized in such forums as the United Nations.

Pretoria's actions over the course of the 1960s to further institutionalize apartheid and suppress political opposition intensified international condemnation of South Africa. During that

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Table 1: **Japan's Imports from South Africa, 1987-91**

(in millions of dollars; c.i.f. value basis)

	1987	1988	1989	1990	1991
Food	$271.5	$181.5	$299.4	$295.7	$209.0
Sugar	68.1	85.4	86.8	76.6	90.2
Textile Materials	68.1	68.4	54.3	39.2	44.9
Metal Ores and Scrap	249.5	274.7	299.2	345.6	355.7
Iron Ore	136.2	116.3	121.2	127.8	146.0
Nonferrous Metal Scrap	107.3	155.9	174.9	215.8	207.4
Mineral Fuels	315.4	271.6	264.5	256.2	269.4
Coal	311.9	266.6	260.5	248.9	264.5
Other Raw Materials	135.7	179.8	200.3	195.3	187.3
Nonmetallic Mineral Ores	72.8	112.3	123.2	128.5	124.7
Chemicals	38.9	64.4	95.7	65.5	60.3
Machinery and Transport Equipment	17.7	15.7	13.9	18.7	12.4
Other	1,162.4	877.3	807.5	626.9	680.2
Steel	216.5	286.3	337.5	222.3	254.9
Nonferrous Metals	636.2	450.9	278.6	293.8	299.6
Total Imports	2,259.2	1,933.2	2,034.8	1,843.0	1,819.3

Source: Japan Tariff Association

Table 2: **Japan's Exports to South Africa, 1987-91**

(in millions of dollars; f.o.b. value basis)

	1987	1988	1989	1990	1991
Food	$12.0	$10.4	$12.7	$10.1	$9.7
Textile Materials, Fabrics and Clothing	54.4	59.5	49.2	44.1	45.8
Chemicals	77.3	83.5	72.9	68.9	75.9
Nonmetallic Mineral Products	11.1	16.2	17.9	18.6	18.6
Metal Products	116.5	151.2	126.6	103.8	104.9
Steel	87.1	76.3	75.4	57.2	55.8
Machinery and Transport Equipment	1,489.6	1,610.2	1,326.0	1,124.9	1,236.3
Power Generating Machinery	49.0	167.9	199.5	175.1	174.0
Office Machinery	51.4	42.3	28.6	25.8	30.8
Motor Vehicles	373.8	305.4	143.5	119.7	127.0
Scientific and Optical Equipment	65.7	75.9	63.1	63.0	73.0
Audio and Videocassette Recorders and Players	32.8	28.9	19.9	25.4	31.4
Other	102.4	115.9	111.9	106.8	143.6
Total Exports	1,863.3	2,046.8	1,717.3	1,477.0	1,634.7

Source: Japan Tariff Association

decade Tokyo established restrictions on direct investment in South Africa and reconsidered bilateral discussions aimed at establishing full diplomatic relations. In 1961 Pretoria designated Japanese citizens "honorary whites." Although the Japanese government did not officially accept this status, Japanese citizens taking advantage of freedoms generally denied to Asians in South Africa were open to charges that they, in effect, accepted a system of institutionalized discrimination.

During the 1970s many Japanese companies established branch offices in South Africa or arranged with locally owned firms to assemble and/or distribute their products. Several Japanese automotive manufacturers, tire companies and producers of electronics products and appliances established a presence in South Africa during this period. Also early in the decade Japanese steel mills entered long-term contracts to import iron ore and coking coal from South Africa. Japan's large power companies similarly turned to South Africa to meet their increased uranium needs. Japanese trading companies eventually became involved there in infrastructure improvements needed for resource extraction.

Limits on Growing Japan-South Africa Ties - These links contributed to the expansion of Japan-South Africa trade and gave certain Japanese industries, particularly computer and automotive manufacturers, a dominant position in South Africa's markets. As antiapartheid sentiment grew, the Japanese government followed the United States and European nations in 1985 in imposing further constraints on transactions with South Africa. Restrictions announced that year included a ban on the export of computers to government agencies enforcing apartheid and a call for Japanese citizens to refrain from purchasing and importing Krugerrand gold coins. Tokyo also said it would press South African subsidiaries of Japanese companies to promote equal employment opportunities. Meanwhile, Japanese leaders stepped up calls for Pretoria to end its racially discriminatory policies and urged the government to pursue direct negotiations with black nationalist leaders.

The next year Japan again joined the United States and other nations in another round of sanctions against Pretoria. Tokyo announced that it would ban all steel purchases (with the exception of imports already under contract) as well as suspend tourist visas to South African citizens and discourage Japanese tourism to that country. (Restrictions on sports, educational and cultural exchanges with South Africa later were revised to exempt black South Africans and those attending antiapartheid conferences in Japan.) Reciprocal airline landing rights between Japan and South Africa also were suspended. Moreover, Japanese government employees were forbidden to use South African Airways international flights.

International Criticism of Japan's Approach - Yet many in the international community claimed that these measures did little to stem Japanese transactions with South Africa. Some critics charged that Japanese firms could circumvent the restrictions by such means as investing in South Africa through third countries and selling computers to local dealers. Despite Tokyo's policy of discouraging lending to that country, Japanese banks and securities companies reportedly made significant loans to private and government-owned companies in South Africa.[1] Observers argued that such activities would undermine the bans imposed by other nations while benefiting Japanese commercial interests. Concern in the United States that Tokyo would not enforce effectively its sanctions against Pretoria led to the inclusion of an amendment in the Comprehensive Anti-Apartheid Act of 1986 authorizing the president to limit U.S. imports from any country that "benefits from, or otherwise takes commercial advantage of" American sanctions.

An unofficial visit to Japan by South African Foreign Minister Roelof "Pik" Botha in 1986 added to international apprehension about Japan's relations with South Africa. At the same time Prime Minister Yasuhiro Nakasone derogatorily commented that the educational achievements of American blacks and Hispanics lowered the American average. This exacerbated the impression that Japan was insensitive to racial issues. In 1987 international criticism of Japan further intensified when reports of its two-way trade with South Africa listed it as that country's number-one trading partner (see Table 3). In late 1988 when the United Nations General Assembly passed a resolution calling for a ban on trade with South Africa delegates singled out Japan and denounced it for being Pretoria's top

Table 3: **South Africa's Major Trading Partners, 1986-90***

(in millions of dollars; exports f.o.b., imports c.i.f.)

Trading Partner	1986	1987	1988	1989	1990
West Germany					
Exports	$1,941	$2,548	$3,332	$3,263	$3,044
Imports	1,376	1,248	1,727	1,553	1,822
Total Trade	3,317	3,796	5,059	4,816	4,866
Great Britain					
Exports	1,247	1,557	1,912	1,699	1,983
Imports	1,218	1,073	1,425	1,447	1,915
Total Trade	2,465	2,630	3,337	3,146	3,898
United States					
Exports	1,158	1,281	1,691	1,659	1,732
Imports	2,476	1,399	1,575	1,586	1,752
Total Trade	3,634	2,680	3,266	3,245	3,484
Japan					
Exports	1,249	1,882	2,047	1,737	1,491
Imports	2,266	2,436	1,955	2,047	1,858
Total Trade	3,515	4,318	4,002	3,784	3,349
Italy					
Exports	352	456	501	637	694
Imports	1,916	1,788	2,163	2,621	2,546
Total Trade	2,268	2,244	2,664	3,258	3,240
France					
Exports	405	467	581	563	509
Imports	486	583	708	755	750
Total Trade	891	1,050	1,289	1,318	1,259

Note: Ranked in terms of total 1990 trade.

*Based on trading partners' data as reported by the International Monetary Fund. Therefore, West Germany's exports to South Africa are a proxy for South Africa's imports from West Germany, while West German imports from South Africa are a proxy for South African exports to West Germany.

Source: International Monetary Fund, *Direction of Trade Statistics Yearbook.*

trade partner. Certain members of Congress also were stepping up pressure for Japan to further restrict trade with South Africa. The chairman of the Congressional Black Caucus, Rep. Mervyn Dymally (D, Calif.), proposed a model for Japanese behavior in international interracial relations that included a call for Japanese companies to cut off their trade with South Africa. Meanwhile, though, election-year issues crowded out Capitol Hill's efforts to impose additional sanctions on Pretoria.

Tokyo attributed the high trade figures targeted by its critics in large part to the yen's appreciation. Since early 1988, the Japanese government pointed out, trade had been declining in dollar terms; officials cited this as proof of Japan's determination to decrease economic ties with South Africa. In response to the increasing criticism Tokyo had asked Japanese companies earlier that year to keep two-way trade with South Africa at or below the 1987 level in dollar terms.

Yet the decline in transactions with South Africa indicated by Japanese trade figures after 1988 (see Table 4) did not ease charges that Japan was continuing business as usual with that country. Some observers, for example, discounting decreases in Japan's purchases of South African metals,

Table 4: **Japan's Trade with South Africa, 1986-91**

(in millions of dollars; exports f.o.b., imports c.i.f.)

	1986	1987	1988	1989	1990	1991
Exports	$1,355.2	$1,863.3	$2,046.8	$1,717.3	$1,477.0	$1,634.7
Imports	2,228.7	2,259.2	1,933.2	2,034.8	1,843.0	1,819.3
Total Trade	3,583.9	4,122.5	3,980.0	3,752.1	3,320.0	3,454.0

Source: Japan Tariff Association

charged that the firms had shifted to sourcing South African products from third countries. In explaining the limited extent to which imports were cut from South Africa, some Japanese industries claimed dependence on South African products, while others voiced a concern that alternative sourcing would escalate import prices. Several Japanese companies were said to be considering cutting back their operations in South Africa during this period. Matsushita Electric Industrial Co., Ltd., for one, closed its office in Johannesburg in early 1989. Bank of Tokyo, Ltd. and Konishiroku Photo Industry Co., Ltd. also were reported to have pulled out of South Africa.[2] However, a 1990 survey by Washington, D.C.-based Investor Responsibility Research Center Inc. listed no Japanese firms as being among the 181 international companies that had severed direct investment ties with South Africa since 1984.[3]

Pressures on Japan's South Africa Policies and Practices

In enacting economic sanctions against Pretoria in 1986 Congress went against the wishes of the Reagan administration, which argued that such restrictions hurt black South Africans. Many lawmakers felt that the White House position did not reflect that of the American public. Since the Reagan as well as the Bush administration disliked imposing sanctions and did not ask allies to take similar steps, pressure on Japan to limit its economic ties to South Africa stemmed from certain members of Congress as well as church-related and other groups.

Among the groups watching the actions of Japanese companies as well as American firms has been the Interfaith Center on Corporate Responsibility, a coalition of church-related institutional investors. Timothy Smith, executive director of ICCR, says that his group has been critical of certain Japanese companies' sales and nonequity ties to South Africa. Such connections are one factor the group's members consider when making purchasing or portfolio decisions, he has noted.[4]

As antiapartheid protests built up steam across America, institutional purchasers and investors, including cities and states, began examining their ties to South Africa. This process led them to scrutinize the trade and investment policies of the companies they dealt with, including Japanese firms. Currently 140 South Africa-related restrictions are in effect at the state and local level in this country. More than 50 states and localities have selective contracting laws that allow government discrimination against any firms with ties to South Africa. Some observers are skeptical that pressure from interest groups or state and local governments in this country greatly influenced Japanese companies on their decisions vis-a-vis South Africa. Those who acknowledge that some Japanese companies changed their trade patterns include critics who contend that the corporations did so because they were concerned primarily about being inconvenienced in other relationships, not because they were committed to change in South Africa.

A similar complaint has been made against the Japanese government; some observers charge that maintaining smooth ties with the United States was a greater concern to the Japanese government than the state of race relations in South Africa. Others point out that, in the context of a tense bilateral atmosphere, Tokyo recognized the need for caution on this volatile matter and responded by pursuing a low profile on the issue. Japanese government officials acknowledge that, before F.W. de Klerk became president of South Africa and set in motion the policy of dismantling the apartheid system, Tokyo's stance on South Africa was predicated on avoiding unnecessary criticism. Another perception is that the Japanese government played both sides of the South Africa issue, fostering contacts with the African National Congress, the main opponents of apartheid, as well as with Pretoria. Although criticized by some observers as taking a cynical stance, Japanese government officials have emphasized the importance of dialogue and improved business ties in Tokyo's relations with South Africa. Moreover, Tokyo recently has been encouraged by the Bush administration to pursue what it views as a balanced approach to South Africa.

Foreign observers note that within Japan opposition to the government's policies toward South Africa has been slight. Nonetheless, Foreign Minister Botha's unofficial visit to Japan in 1986 was greeted by demonstrators from the Japan Socialist Party (now known as the Social Democratic Party of Japan) and antiapartheid groups. In 1988 Takako Doi, then chairperson of the Socialist Party, called on Tokyo to impose comprehensive economic sanctions against Pretoria and to renounce its "honorary white" status for Japanese. When President de Klerk visited Japan this June (see *JEI Report* No. 22B, June 12, 1992), antiapartheid activists repeated Ms. Doi's appeal and asked Prime Minister Kiichi Miyazawa to request a formal withdrawal of the label. The groups also presented a petition to Mr. Miyazawa calling on him to withhold loans to Pretoria until an interim government is established in South Africa.

The Japan Anti-Apartheid Committee, a small group established in 1964, also has protested Japanese economic involvement in South Africa. In contrast, groups including the Japan-South Africa Parliamentarians' Friendship League, the Nippon Club of South Africa and the Springbok Club of Tokyo in the past pushed for restoration of full diplomatic and economic ties with South Africa to protect Japanese business interests there.[5] Reportedly there also has been disagreement between and within Japanese government agencies over the timing and the nature of measures to protest Pretoria's policies and, more recently, to encourage reforms.

Responding to Recent Reforms

As President de Klerk began to work toward dismantling South Africa's system of apartheid the Japanese government responded with steps to restore economic and diplomatic ties to that country. In June 1991, following the South African Parliament's repeal of the Population Registration Act — considered the legal foundation of the apartheid system, Tokyo removed certain restrictions on personnel exchanges between the two countries (see *JEI Report* No. 24B, June 28, 1991). At the same time the Ministry of International Trade and Industry indicated an easing of the 1988 guideline concerning trade with South Africa. That October the Japanese government, saying that it considered the reform process in South Africa "irreversible," announced the lifting of most of its remaining sanctions there (see *JEI Report* No. 41B, November 1, 1991). Tokyo's actions on economic sanctions followed similar decisions by the United States, the European Community and the Commonwealth nations. Early this year the Japanese government took another step toward solidifying bilateral relations by announcing the immediate establishment of full diplomatic relations with Pretoria (see *JEI Report* No. 3B, January 24, 1992).

Although most observers concur that Tokyo has moved cautiously toward normalizing relations with South Africa, it has not avoided criticism from the Tokyo office of the African National Congress, which characterized the move to lift sanctions as "overly hasty." The ANC describes the function of its office in Tokyo, like its Washington counterpart, as providing information to ensure that policy toward South Africa is informed. Positions taken publicly by the ANC in Tokyo underscore the complexity of the task that Japan and other nations face as they review their approaches to South Africa. One expert, who preferred to remain unidentified, notes that the question for Tokyo and other governments seeking to restore ties to South Africa will be "bilateral relations with whom?" In preparation for a potentially disparate leadership in South Africa the Japanese government will need to expand its contacts with the ANC, this expert says.

The ANC is encouraging governments not to foster relations with Pretoria until an interim government is chosen, which at this point does not appear to be within easy reach. The Convention for a Democratic South Africa, a forum of 19 political parties participating in negotiations intended to draft a new constitution for the country, currently is stalled over differences regarding the size of the majority needed to approve the new constitution. Many additional questions remain about the transition to democracy in South Africa. Observers note that other nations should be prepared for confusing and contradictory messages from the interim executive council, which is expected to group black leaders, including ANC president Nelson Mandela, and members of the de Klerk government. Mr. Mandela's fall 1990 visit to Japan was viewed by some as a significant step forward for Japan-South Africa relations (see *JEI Report* No. 43B, November 9, 1990), but the long-standing antiapartheid symbol appeared dissatisfied during his visit when then Prime Minister Toshiki Kaifu responded to the ANC's request for financial assistance with the comment that "there is no precedent" for Tokyo to provide direct assistance to political organizations in other countries.

Supporting Reform through Economic Assistance

Japan's potential to help spur South Africa's economic development also was a focus of recent visits by Foreign Minister Botha and President de Klerk (see *JEI Reports* No. 13B, April 3, 1992, and No. 22B, June 12, 1992). Both Japanese and South African officials have emphasized the importance of economic growth to the transition toward democracy. Tokyo has indicated that due to South Africa's relatively high per capita income, support from Japan is most likely to be provided in the form of technical assistance.

Japanese Government Assistance - Japan already has contributed to several South African programs, mostly channeled through third parties, including the United Nations and a Japan-European Community fund (see Table 5). In addition, Tokyo has supported technical training programs in Japan for South African blacks and in FY 1990 initiated a small-scale grant program aimed at providing education, vocational training and other support for black communities. In early 1991 Japan provided a South African nongovernmental organization with funds for scientific equipment to be used by black schools in the Transvaal region; the pledge was its first direct assistance to a South African group. Under the Ministry of Foreign Affairs' coordination two private Japanese groups, the African Society and Risho Koseikai, also fund scholarships for South Africans. The program is administered in South Africa by the African Educational Trust.[6] Although Japan's financial contributions in this area are small compared to those of the United States, to some extent the two governments have followed similar paths.

Over the last 10 years the U.S. Agency for International Development has extended almost $200 million to help South Africa's black population, with FY 1992 funding reaching $80 million. To date the funds have been channeled through South African nongovernmental organizations as set out by the Comprehensive Anti-Apartheid Act, but U.S. officials indicate that once an interim government is in place Washington could extend direct assistance to South Africa. Japanese officials predict that Tokyo also may interpret this politicial development as a go-ahead for government-to-government assistance.

Moreover, Tokyo is considering an expansion of its assistance to the entire southern Africa region, which includes Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, Swaziland, Tanzania, Zambia and Zimbabwe as well as South Africa. In May Tokyo announced an extension of aid worth ¥10.9 billion ($80.7 million at ¥135=$1.00) to drought-stricken southern Africa in anticipation of an appeal from the United Nations and the Southern African Development Cooperation Conference.

Pretoria has emphasized its potential to lead the economic growth of southern Africa, a possibility Tokyo is watching closely. Foreign Ministry officials have indicated that Pretoria's development of good relations with its neighbors will factor into whether Japan looks to South Africa as the locomotive for its development assistance efforts in the region. During Mr. de Klerk's trip to Japan he and Prime Minister Miyazawa agreed to cooperate in promoting the economic development

Table 5: **Japanese Government Support for Antiapartheid Organizations**

(in thousands of dollars)

	Actual FY 1990	Actual FY 1991	Committed FY 1992	Total Through FY 1991
United Nations				
U.N. Trust Fund for South Africa	$20	$20	$20	$400
U.N. Trust Fund for Publicity Against Apartheid	10	10	10	160
U.N. Educational and Training Program for Southern Africa	400	660	660	4,580
UNHCR Political Refugees Program*	0	3,200	0	3,200
With European Community				
Special Joint Programs for South African Blacks	1,000	1,500	2,500	3,950
Small-Scale Grant Program	110	220	270	330
Total	1,600	6,190	n.a.	13,260
Number of trainees accepted by Japan International Cooperation Agency	6	21	40	640

*One-time contribution.

Source: Ministry of Foreign Affairs

of the region; Japanese officials had indicated that regional issues would be an important focus of the trip.

Tokyo tentatively plans to invite leaders of African nations to Japan next year for a meeting to discuss the development issues facing their nations. The Japanese government and the private sector also are slated to participate in a second conference with the New York City-based African-American Institute this year or in early 1993. Last year the first in the series of conferences reviewed coordinated responses toward African development needs (see *JEI Report* No. 32B, August 23, 1991).

Private-Sector Assistance - The Japanese private sector also has taken steps to assist black South Africans. In 1989 the South Africa Trade Association, a group backed by Keidanren (Japan Federation of Economic Organizations), initiated a drive to raise ¥400 million ($2.9 million) to assist "nonwhite" college students and businesses in South Africa. To date ¥320 million ($2.4 million) has been raised; the funds are to be disbursed over 10 years. The program is considered a prototype; a recent Keidanren assessment of the projects underway in South Africa is expected to factor into the organization's decision to contribute additional educational and technical assistance.

Private-Sector Perspectives on Approaching South Africa

Japan's former consul general and recently named ambassador to South Africa, Masatoshi Ota, may have expressed the views of many Japanese interests when he commented, "We're not aiming at this country alone; we see South Africa as the route to the rest of southern Africa."[7] South African officials echo this view, pointing out that, as the most developed country on the continent, South Africa could serve as a jumping-off point for Japanese and other foreign firms considering investment in the rest of Africa.

According to one report, Japan has safeguarded its trade potential with South Africa by consulting with that country's neighbors and securing the go-ahead from the Organization of African Unity to explore investment possibilities there.[8] Japanese business leaders indicate the private sector also has been encouraged by South Africa's recent decision to join the Southern African Development Coordination Conference, which previously sought to narrow its 10 members' economic dependence on Pretoria while coordinating development plans.

Current Presence in South Africa - A number of Japanese companies already have a stake in South Africa. In its 1990 survey the Investor Responsibility Research Center identified three Japanese firms with direct investment (defined as controlling at least 10 percent of the equity in an active company) in South Africa and a further 20 with employees there.[9] In contrast, in late 1991 IRRC listed 104 American firms with direct investment or employees in South Africa and 192 with nonequity links.[10] IRRC cited 43 Japanese firms with nonequity ties to South Africa in 1990. Companies with contracts or licensing, distribution, franchising, technological or trademark agreements with firms in South Africa were included in this second category. In addition, the products of three Japanese companies are distributed in South Africa, although they have no investment or formal nonequity links in that country, according to IRRC. Although 167 American companies have disinvested from South Africa since the beginning of 1986, U.S. companies' nonequity links with that country have been on the rise overall, according to IRRC.[11]

Japan's business community has taken steps to prepare for further involvement in South Africa. This June the Japanese Chamber of Commerce and Industries in South Africa was formed with the intention of coping with the normalization of bilateral relations, according to the new organization's president, Shuji Okita. The group represents more than 30 companies or organizations in the southern Africa region. And last year Keidanren sent a mission to South Africa to assess social and economic conditions there (see *JEI Report* No. 19B, May 17, 1991). The group met with President de Klerk and members of his government as well as antiapartheid leaders and representatives of the black business community. It concluded that restrictions on investments and financial support had affected the economy and the social environment critically.

This May Keidanren led another mission to meet with government and business leaders in South Africa as well as in the Republics of Zambia, Zimbabwe and Botswana. In contrast to last year's trip, which focused on exchanging views with South Africans, the latest mission explored business, investment and development opportunities in the entire region. The fact that a large contingent from Japan's mining and steel industries participated in the recent Keidanren mission indicates one area in which prospects are considered good for increased Japan-South Africa trade. Masamichi Fujimori, who led the business group, specifically commented on the potential for Japan to boost imports of nonferrous ores and metals, including copper and nickel, and to export more mining technology to South Africa.

Potential Areas for Expansion - Other business leaders note that with political instability in the former Soviet Union threatening that important source of precious metals, Japan's automotive industry in particular will be drawn to South Africa. Toyota Motor Corp. officials have indicated that the manufacturer's dependence on South African companies for the platinum used in catalytic converters would increase from the current figure of almost 60 percent to 70 or 80 percent over the next few years.

While Japanese firms' purchases of South African industrial inputs are expected to rise, so also are their sales to that country of consumer goods, including cars and electronics products, especially computers. Analysts anticipate more Japanese firms will invest in mining as well as chemical and certain equipment manufacturing operations in South Africa now that sanctions have been lifted. Japan's private sector also is said to be considering South Africa as an export-oriented manufacturing base. One analyst expects Japanese trading companies to invest heavily in the oil seed sector in South Africa, one of the few regions of the world where the commercial potential of these commodities remains untapped.[12] The main forum for new investment initially will be joint ventures, possibly with the participation of South Africa's neighbors, according to Japanese and South African observers.

Some Japanese trading companies already have set up affiliated firms as they bid to expand their transactions with South Africa. A representative of Mitsui & Co., Ltd., a major player in Japan-South Africa trade, recently commented that despite the private sector's cautious stance, Japanese trading companies already are competing for business opportunities in southern Africa.[13] Mitsui is said to have set up 55 new affiliates in the southern Africa region with the aim of expanding coal, iron ore and precious metal imports and venturing into new sectors. In contrast, the largest Japanese trading company in South Africa, Nissho Iwai Corp., may expand exports to South Africa by 20 to 30 percent within the next couple of years but is not expected to increase investment there until late 1994 when a new government is in place.[14]

For its part, Pretoria reportedly has conveyed to Japanese business representatives the hope that Japan will help develop South Africa's tourism industry. Growth in this sector apparently is seen as a key to boosting not only personal but business exchanges between South Africa and other countries. Although the Japanese Chamber of Commerce and Industries' Mr. Okita recently predicted that "If all goes well, we could see the first big investment in South Africa in about one year," many Japanese interests remain cautious about increasing trade with South Africa and are particularly wary of committing the capital needed to start up operations there.

Ambivalence Among Investors - During an April visit to Japan, South Africa's Minister for Trade and Industry, Derek Lyle Keys, reportedly made a pitch for Japanese automotive companies to invest in his country. In particular Mr. Keys reportedly hoped to spur Mazda Motor Corp. to invest in South African Motor Corp., which currently imports components from and maintains a licensing agreement with the Japanese manufacturer. Yet Pretoria's current tariff structure and an anticipated rise in production costs appear to have contributed to Japanese automotive companies' caution about expanding their presence in South Africa, where, together with Ford Motor Co., they have a firm hold on the motor vehicle market.

Japanese banks also are expected to move cautiously toward increasing loans to South Africa. In part, Japanese banks are restrained by the need to restrict asset growth to ensure that they can fulfill international capital-asset standards. This currently is of major concern in light of recent stock market losses in Japan (see *JEI Report* No. 17B, May 1, 1992). Another worry is that their U.S. branches might face repercussions from state and local governments with South Africa-related restrictions, particularly in California where major Japanese commercial banks have extensive retail banking operations.

Some members of Japan's business community are waiting to make investment decisions because they do not want to trigger outside criticism for expanding contacts with South Africa too quickly; many are likely to be watching for further international recognition of political progress in that country. The ANC has said that it will call for the removal of economic sanctions once the interim government is in place, a step that is expected to spur localities in this country to lift their South Africa-related restrictions. Japanese officials predict that these events will ease private-sector concerns universally.

Yet many Japanese corporate executives also indicate that South Africa's slow economy and high rates of inflation and unemployment temper the business opportunities the country offers. In recent years inflation has persisted at a pace of 14 percent or greater, while unemployment is thought to be higher for the country as a whole than the 19 percent recorded by Pretoria for 1991. Earlier this year the independent Japan Bond Research Institute of Tokyo gave South Africa a "C" risk rating, ranking that country above the former Soviet Union in its estimate. Many companies in Japan and elsewhere also will be following the development of South Africa's relationship with the International Monetary Fund; normal ties with that body would decrease the economic risks for investors and financial institutions interested in South Africa.

Political stability, however, remains key to investor confidence in South Africa — or the lack of it. With violence continuing to ravage South Africa's black townships, volatility remains high. All three primary political forces in the country maintain armed contingents. The president of the Japanese Chamber of Commerce in South Africa recently noted, "A clear economic policy and political settlement are prerequisites to Japanese investment in South Africa."[15]

Moreover, political transition is expected to bring new economic policies in South Africa. Outside observers have been particularly anxious about the possibility that the ANC will seek to implement nationalization policies; most analysts anticipate some sort of economic redistribution under the new South African administration. Last year ANC leaders reportedly advised the Keidanren mission that South Africa's water and electric utilities plus other providers of economic services could be nationalized. ANC representatives recently have indicated that the party's objective is a "mixed economy" and that they will seek labor-intensive investment; particularly welcome will be companies willing to train black South Africans. During his June Tokyo trip President de Klerk also expressed his expectation that Japanese investment would infuse new technology and elements of entrepreneurship into South Africa.

New Challenges for Japanese Companies and Policymakers

Although governments around the world have eased many of their restrictions on relations with Pretoria, South Africa's transition toward a fully representative government presents new challenges for multinational companies seeking to continue or expand relations with that country. Disparate demands and expectations are likely to face both the private sector and policymakers in Japan as well as other nations.

Expectations for the Private Sector - Many observers see a socially responsible approach as crucial for companies seeking to expand their ties with South Africa. While black leaders are expected to accept some international investors more enthusiastically than others, those companies that look beyond business outcomes and make a concerted effort to address social needs are more likely to have smooth relations with South Africa. The extent to which foreign investors recruit black South Africans for management positions is expected to be a key factor in their success. Observers also note that it will be particularly important for investors to work with South Africa's unions. Union membership in that country more than doubled between 1978 and 1988; underlying this growth was a spurt in membership among black South Africans. This March the Congress of South African Trade Unions announced a draft investment code that encourages guidelines on work conditions, affirmative action, training and social programs.

Groups in South Africa as well as companies and church organizations in this country are formulating their own suggested guidelines for investing in South Africa. Antiapartheid activists in Japan used the occasion of President de Klerk's recent visit to urge Prime Minister Miyazawa to advise corporate Japan regarding possible codes of conduct that would ensure favorable treatment for black South Africans. Social responsibility in South Africa may be a particularly sensitive issue for Japanese investors, some of which in the past have been charged with failing to meet community expectations in this country (see *JEI Report* No. 18A, May 4, 1990). Currently some Japanese companies involved in South Africa support educational and small business development programs there. Yet some Japanese business representatives caution that while a number of companies may see attention to social needs as part of their investment in South Africa, others may be reluctant to take on the costs and the complications of this responsibility.

Challenges for the Japanese Government - To press for political and social change in South Africa both the private sector and the government in Japan have employed the threat of limited bilateral economic relations. The Japanese government frequently has issued statements calling for an end to apartheid and, most recently, encouraging the de Klerk government to continue with political reforms. Moreover, Japanese government officials feel that by supporting President de Klerk's reform efforts, expressing concerns about violence in South Africa and promoting bilateral business ties, Japan can continue to serve an important role in encouraging the process of democratization underway in Pretoria.

Yet some observers believe that Japan could be taking a larger part in the transition process. Japan's current and potential economic presence in the region provides Tokyo with a strong voice in South Africa. Vivian Derryck, president of the African-American Institute, notes that there is a great deal of respect in South Africa for Japan's economic success and disciplined work force.[16] She observes that South Africa's multiethnic work force will pose abundant challenges for that country and suggests that Japan could make a significant contribution to South Africa by providing training for workers.

While Tokyo considers the constitutional negotiations underway in Pretoria strictly a domestic matter for South Africans, some observers in this country emphasize that Japan could contribute to a process of political convergence by more visibly encouraging the parties involved to continue their talks and by challenging Pretoria to deal with the violence in that country. ANC representatives note that their party has not approached individual governments regarding an intermediary role in CODESA; however, through such forums as the United Nations and the Organization of African Unity the ANC has called on the international community to press Pretoria to conclude the agreements necessary to move ahead with the transitional government. Once the interim administration is in place, observers note, South Africa may turn to the international community for such needs as monitoring the internal security of that country.

Outlook

A Japanese government spokesman described President de Klerk's recent visit to Japan as opening "a new page in our bilateral relations" and said that the event would be a major impetus for stepping up relations with South Africa. As that country strives to achieve equitable political and social structures Japanese policymakers and business leaders are likely to face myriad challenges to shape new approaches to a postapartheid South Africa.

As business interests around the world begin to compete for the opportunities offered by changes in South Africa, certain companies from Japan as well as the United States have advantages. Observers point out that many South Africans appreciate Japan as a model of economic success while lauding this country for its support of racial equity in the region. At the same time, growing globalization implies that those seeking new ties to South Africa will need to address the expectations of an increasingly international audience as well as a more inclusive South Africa.

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Tooru Ando provided research assistance.

Notes

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[3] Alison Cooper, *International Business in South Africa 1990* (Washington, D.C.: Investor Responsibility Research Center Inc., 1990).

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JEI

REPORT

A Two-Part Report: A and B

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Reports Doubted On Japanese Bank Debt

Concerns about the financial condition of Japanese banks remain high among domestic and foreign analysts despite reassuring statistics and statements from Japanese government and bank spokespersons. The recent data, in fact, have aggravated rather than salved these worries. Because banks play a critical role in economic activity, uncertainty about their health has cast another shadow over Japan's already cloudy economic outlook.

In an effort to quell rumors — generated primarily by the weak stock and real estate markets — about the stability of the Japanese banking system the Ministry of Finance took the unprecedented step in late April of releasing aggregate figures on the profits of top banks in the year ended March 31 as well as data on the amount of loans in arrears (see *JEI Report* No. 17B, May 1, 1992). MOF calculated that the country's 11 nationwide commercial banks, seven trust banks and three long-term credit banks held bad loans (those on which no interest payments had been made for more than six months as of the end of FY 1991) totaling a maximum of ¥8 trillion ($59.3 billion at ¥135=$1.00). This amounted to about 2.4 percent of the banks' total outstanding loans of ¥340 trillion ($2.5 trillion). MOF and Bank of Japan officials have pointed out that the 11 nationwide commercial banks added ¥344.1 billion ($2.5 billion) to their loan-loss reserves during the April 1991-March 1992 period — nearly five times the ¥69.4 billion ($514.1 million) they put aside in the previous fiscal year. That set-aside brought their total bad loan reserves to ¥647 billion ($4.8 billion), according to MOF, while the top 21 banks' bad debt reserves had reached ¥2.3 trillion ($17 billion) at the end of FY 1991. In addition, the Finance Ministry asserted that the banks' stock portfolios contained unrealized profits worth ¥10.8 trillion ($80 billion) as of March 31. This amount would provide an adequate cushion if all nonperforming loans fell into default, MOF authorities suggested.

Private estimates of nonperforming bank loans had been running as high as ¥30 trillion ($222.2 billion) until an internal BOJ analysis was leaked in late May. According to press reports, BOJ calculated the loan arrears faced by Japan's 21 largest banks at ¥26.4 trillion to ¥35.4 trillion ($195.6 billion to $262.2 billion) as of the end of March. The entire banking system, these reports said, carried between ¥42 trillion and ¥56 trillion ($311.1 billion and $414.8 billion) in nonperforming assets. Even if BOJ's figures are off by as much as one-half, Japanese banks obviously are ill-prepared to cover the debt.

The situation may be even worse. During the stock and real estate booms of the late 1980s many banks created nonbank financial subsidiaries and backed their loans. These subsidiaries were freer to participate in the rampant speculation than their parent banks. With both stock market and real estate prices down sharply from their boom levels, these nonbank subsidiaries have watched their problem loans multiply with frightening speed. According to a recently released MOF survey of 300 nonbank firms (not all associated with banks), more than 15 percent of the nonbanks reported bad loans at the end of 1991 valued three to five times higher than the year before; a shocking 47 percent experienced bad debt increases of more than fivefold. According to a private research company, 19 nonbanks affiliated with commercial banks were saddled with ¥233.5 billion ($1.7 billion) worth of bad debts as of May 31. A February MOF study of housing loan companies revealed equally disturbing news. Each of the eight companies queried had from ¥20 billion to ¥40 billion ($148.1 million to $296.3 million) worth of loans in arrears; loans on which no interest had been paid for more than a year topped ¥200 billion ($1.5 billion). Since many of these nonbanks are poorly capitalized, analysts are concerned that the commercial banks backing them will be liable for their bad loans.

Not only does it appear that commercial banks may be liable for nonbank debts but they also may be expected to bail out or absorb financially insolvent smaller banks and other financial institutions. Analysts fear that the case of Toyo Shinkin Bank Ltd. will become a model for resolving future bank failures (see *JEI Report* No. 18B, May 8, 1992). In this case MOF cajoled Sanwa Bank, Ltd. and Industrial Bank of Japan, Ltd. into bearing a large part of Toyo Shinkin's debts. Sanwa assumed ¥80 billion ($592.6 million) of Toyo Shinkin's ¥252 billion ($1.9 billion) worth of liabilities. For its part IBJ forgave 70 percent of its loans to Toyo Shinkin, and an IBJ affiliate wrote off 42 percent of the loans it had made. In addition, IBJ will provide ¥50 billion ($370.4 million) worth of low interest loans to Sanwa over the next several years.

Some large commercial banks also are bracing for the fallout from a series of loan fraud scandals that occurred last year. Besides setting aside more money for bad debts, the 11 nationwide commercial banks lifted so-called specific reserves from ¥492 billion ($3.6 billion) to ¥836 billion ($6.2 billion) in FY 1991 to cover potential losses and damage claims arising from the scandals.

All together, analysts fear, these potential liabilities will decimate bank profits; they also could drain both bank and government reserves established to cover bad debts. Even if MOF's conservative ¥8 trillion ($59.3 billion) bad debt figure is correct, economists predict it will take at least five years for banks to work their way out from under this burden. If BOJ's ¥56 trillion ($414.8 billion) figure is closer to the truth, however, Japanese bank profits could take quite a while to recover. With such a gloomy outlook, it is not surprising that bank stocks have led the Tokyo stock market's decline since the beginning of this year.

The uncertain situation facing major Japanese banks has focused new attention on policies dictating the preparation for bad debts, their disclosure and their classification. When real estate and stock prices were rising, Japanese banks' use of latent real estate and stock profits to back new lending was seen as a competitive strength. Now that land and stock prices are falling, the practice is considered a threat. Falling prices for both types of assets have led many analysts to question the

Japan's Foreign Direct Investment by Country, FY 1987-FY 1991

(in millions of dollars)

	FY 1987	FY 1988	FY 1989	FY 1990	FY 1991	Cumulative March 31, 1992
United States	$14,704	$21,701	$32,540	$26,128	$18,026	$148,554
Canada	653	626	1,362	1,064	797	6,454
North America	15,357	22,328	33,902	27,192	18,823	155,008
United Kingdom	2,473	3,956	5,239	6,806	3,588	26,186
Netherlands	829	2,359	4,547	2,744	1,960	14,776
Luxembourg	1,764	657	654	224	266	5,873
West Germany	403	409	1,083	1,242	1,115	5,805
France	330	463	1,135	1,257	817	4,973
Switzerland	224	454	397	666	62	2,558
Spain	283	161	501	320	378	2,245
Belgium	70	164	326	367	222	1,941
Italy	59	108	314	217	322	1,222
Ireland	58	42	133	49	102	716
Europe	6,576	9,116	14,808	14,294	9,371	68,636
Indonesia	545	586	631	1,105	1,193	12,733
Hong Kong	1,072	1,662	1,898	1,785	925	10,775
Singapore	494	747	1,902	840	613	7,168
Thailand	250	859	1,276	1,154	807	5,229
South Korea	647	483	606	284	260	4,398
Malaysia	163	387	673	725	880	4,111
China	1,226	296	438	349	579	3,402
Taiwan	367	372	494	446	405	3,136
Philippines	72	134	202	258	203	1,783
Asia	4,868	5,569	8,238	7,054	5,936	53,455
Panama	2,305	1,712	2,044	1,342	1,557	17,801
Caymans	1,197	2,609	1,658	588	158	7,489
Brazil	229	510	349	615	171	6,731
Bahamas	734	737	620	121	103	3,562
Mexico	28	87	36	168	193	2,067
Bermuda	36	337	228	360	232	1,810
Virgin Islands	38	133	118	15	614	918
Netherlands Antilles	199	172	38	9	---	795
Peru	1	---	---	---	---	696
Latin America	4,816	6,428	5,238	3,628	3,337	43,821
Australia	1,222	2,413	4,256	3,669	2,550	18,613
New Zealand	121	117	101	231	236	1,161
Oceania	1,413	2,669	4,618	4,166	3,278	21,376
Liberia	267	648	643	531	707	5,539
Africa	272	653	671	551	748	6,574
Kuwait	54	20	32	26	26	1,467
Iran	---	1	1	---	1	1,007
Middle East	62	259	66	27	90	3,522
Total	33,364	47,022	67,540	56,911	41,584	352,392

Source: Ministry of Finance

Japan's Foreign Direct Investment by Sector, FY 1987-FY 1991

(in millions of dollars)

	FY 1987	FY 1988	FY 1989	FY 1990	FY 1991	Cumulative March 31, 1992
Manufacturing Sector	$7,832	$13,805	$16,284	$15,486	$12,311	$93,924
Food Products	328	419	1,300	821	632	4,717
Textiles	206	317	533	796	616	4,615
Wood and Paper Products	317	604	555	314	312	3,280
Chemicals	910	1,292	2,109	2,292	1,602	12,542
Metals	786	1,367	1,591	1,047	907	11,215
Nonelectric Machinery	687	1,432	1,762	1,454	1,284	9,216
Electric Machinery	2,421	3,041	4,480	5,684	2,296	22,656
Transport Equipment	1,473	1,281	2,053	1,872	1,996	12,877
Other	703	4,051	1,901	1,207	2,666	12,804
Nonmanufacturing Sector	25,080	32,634	50,517	40,620	28,809	251,946
Agriculture and Forestry	97	162	151	153	276	1,635
Fisheries	44	94	47	61	72	810
Mining	511	1,013	1,262	1,328	1,003	17,542
Construction	87	309	646	300	420	2,809
Trade and Sales	2,269	3,204	5,148	6,156	5,247	36,564
Banking, Finance and Insurance	10,673	13,104	15,395	8,047	4,972	70,290
Services	2,780	3,732	10,616	11,292	5,413	40,079
Transportation	2,145	2,372	2,927	2,169	2,489	19,927
Real Estate	5,428	8,641	14,143	11,107	8,899	54,748
Other	1,047	3	180	8	10	7,533
Branch Offices	452	584	739	806	464	5,928
Other Transactions*	---	---	---	---	---	595
Total	33,364	47,022	67,540	56,911	41,584	352,392

*Certain overseas real estate transactions have been excluded from Japan's foreign direct investment data since December 1, 1980 because of changes in the Foreign Exchange and Foreign Trade Control Law.

Source: Ministry of Finance

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REPORT

A Two-Part Report: A and B

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Analysts View Japan's Latest GNP Figures With Caution

The Economic Planning Agency could have had in mind the saying that figures lie and liars figure June 16 when it presented the latest quarterly figures regarding the growth of the Japanese economy. Apparently seeking to avoid a charge of being less than honest, EPA officials sought to explain why the just-released January-March gross national product data were misleading. On paper the reported annualized growth rate of an inflation-adjusted 4.3 percent looked surprisingly good, considering the widely held perception that the Japanese economy was in the midst of a recession (see Table). EPA officials encouraged adjustments, however, that implied that a realistic figure would be far lower.

The effect of EPA's uncharacteristic pessimism was evident in some rethinking apparent on the part of several Japanese analysts. Prior to the data's release these Japanese experts had predicted that Japan's economy would grow a real 4 percent on an annual basis during the January-March quarter. On this premise they took issue with foreign analysts who generally argued that their own estimates, which pointed to the Japanese economy actually shrinking for a second straight quarter, indicated a particularly severe recession — at least by Japanese standards. One might have thought that the Japanese analysts would have used EPA's actual data as confirmation for the correctness of their analysis. The opposite happened. In some instances, at least, the same analysts who had been bullish on the Japanese economy only days before became much more pessimistic. In doing so, they appeared to take a cue from EPA.

Japan's Real Gross National Product at Constant (1985) Prices

(in billions of yen, seasonally adjusted, quarterly totals and rates of growth at annual rates)

	FY 1990	FY 1991	April-June 1991	July-September 1991	October-December 1991	January-March 1992
Gross Domestic Product	¥406,615.1 (5.7%)	¥420,648.2 (3.5%)	¥418,446.7 (4.0%)	¥420,211.8 (1.7%)	¥420,104.1 (-0.1%)	¥423,649.6 (3.4%)
Gross National Product	409,214.5 (5.5%)	423,565.4 (3.5%)	421,003.9 (2.8%)	423,052.8 (2.0%)	422,715.7 (-0.3%)	427,193.3 (4.3%)
Personal Consumption Spending	234,085.0 (4.0%)	240,619.7 (2.8%)	238,652.2 (6.5%)	240,449.8 (3.0%)	240,692.7 (0.4%)	242,690.2 (3.4%)
Private Residential Construction	22,848.6 (4.9%)	20,261.2 (-11.3%)	21,110.7 (-23.6%)	20,620.8 (-9.0%)	19,621.3 (-18.0%)	19,603.6 (-0.4%)
Private Fixed Nonresidential Investment	88,990.7 (12.1%)	91,683.0 (3.0%)	91,559.7 (-3.0%)	92,225.3 (2.9%)	91,491.3 (-3.1%)	91,440.7 (-0.2%)
Change in Business Inventories	2,901.4 (-20.8%)	3,214.6 (10.8%)	3,172.3 (13.7%)	3,420.9 (35.2%)	3,075.5 (-34.7%)	3,218.1 (19.9%)
Government Current Expenditures	34,428.7 (2.4%)	35,428.7 (2.9%)	35,595.7 (6.5%)	35,114.8 (-5.3%)	35,297.1 (2.1%)	35,691.5 (4.5%)
Government Fixed Investment	26,095.1 (4.4%)	27,579.7 (5.7%)	27,378.4 (20.3%)	27,392.6 (0.2%)	27,655.8 (3.9%)	27,826.1 (2.5%)
Change in Government Inventories	95.1 (*)	-197.4 (*)	-199.8 (*)	240.8 (*)	-942.6 (*)	91.8 (*)
Net External Sector	-230.1 (*)	4,975.9 (*)	3,734.7 (*)	3,587.8 (*)	5,824.6 (*)	6,631.3 (*)
Exports of Goods and Services and Factor Income Received	73,760.4 (7.7%)	77,175.7 (4.6%)	74,796.4 (-8.7%)	76,671.6 (10.4%)	77,949.8 (6.8%)	79,214.6 (6.7%)
Imports of Goods and Services and Factor Income Paid	73,990.6 (7.2%)	72,199.8 (-2.4%)	71,061.7 (-7.9%)	73,083.8 (11.9%)	72,125.2 (-5.1%)	72,583.3 (2.6%)

*Cannot be calculated or meaningless.

Source: Economic Planning Agency

EPA and other analysts noted that the biggest problem in the data was the so-called leap-year effect. An extra day in February inflated the reported value of consumer spending, thereby enlarging the calculated increase in annualized GNP growth by 1.6 percentage points. In addition, as in previous years, Japanese companies chose to repatriate their overseas profits in the January-March period, the final quarter of the Japanese fiscal year. Inasmuch as such profits are treated in the GNP statistics as exports, net exports displayed an exaggerated rate of growth from the previous quarter. Gross domestic product, which differs from GNP primarily in that it excludes net foreign profits, grew a much more modest 3.4 percent on an annualized basis in 1992's opening quarter. Finally, another qualification in the data centered on government inventories. In the previous quarter they had fallen due do a poor rice harvest, with the result that even a modest inventory buildup made an unusually large and unsustainable contribution to overall growth. Without the triple effects of a leap year, repatriated income and government inventories, real GNP growth would have been about 1 percent on an annualized basis or less than one-fourth the reported figure.

The almost overnight change in the interpretation of the GNP figures may have been a factor behind the sharp decline in the Japanese stock market the week after the statistics were released, although the market had been weak for several weeks. On June 22 the Nikkei average of 225 stocks closed below 16,000 for the first time since October 1986, dropping to 15,921.22.

The GNP data contain little evidence of a quick, sharp economic recovery. Excess business inventories, widely eyed as the culprit behind production cutbacks since early last year, showed few signs of shrinking in the January-March period; in fact, stocks expanded 19.9 percent on an annualized basis. Housing construction, which played a strong role in pulling the economy out of other recent recessions, continued to decline in the first quarter, although less comprehensive data for more recent months are encouraging. Private plant and equipment spending, another key factor behind Japanese economic growth in recent years, dropped again, albeit remaining at historically high levels.

Of interest to Washington were not only the net export figure, which, as mentioned, was biased upward, but the government spending numbers. Net exports would not have expanded at all without the extraordinary influence of foreign investment income. (Trade data that show a large increase in Japanese net exports in the first quarter are on a nominal, year-to-year dollar basis rather than the real, seasonally adjusted quarter-to quarter yen basis used in the GNP statistics.) Hence, a possible development much feared in Washington — a Japanese export drive to pull the economy out of the doldrums — was not evident in the first quarter GNP statistics. The two government spending categories, by contrast, arguably were the only source of significant growth during the quarter. Their relative robustness could be even more evident in the GNP figures for the April-June period, given the acceleration of FY 1992 public works spending, although that program will take months to be felt fully. The Bush administration has pushed Tokyo to adopt a more expansionary fiscal stance.

Over the longer term government spending and taxation may play an even larger role in the Japanese economy. An increasing number of analysts expect Tokyo to announce an additional economic stimulus package (see following article), perhaps as early as this summer. Some experts believe that Tokyo's expectation of 3.5 percent real economic growth in FY 1992, which began April 1, otherwise could be far too optimistic. (By comparison, the government initially had expected inflation-adjusted GNP to expand 3.8 percent in FY 1991; actual growth came to 3.5 percent.) Business leaders, whose confidence is at the lowest level since the bottom of the previous recession, have added their voices to calls for a more activist fiscal stance.

Douglas Ostrom

Economic Woes Pressure Fiscal Policy

Japanese officials continue to battle against economic pessimism and appear ready to resort to fiscal weapons to break the negative mind-set sapping economic activity. Despite having accelerated the pace of already planned FY 1992 public works spending, Prime Minister Kiichi Miyazawa

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WORK AND LEISURE IN JAPAN

SUMMARY

Japan's reputation as a nation of workaholics, while of relatively recent vintage, is believed widely throughout Japan and abroad. While hours devoted to a paying job are greater in Japan than elsewhere, a broader view of work — as opposed to leisure and daily needs such as sleep — suggests that the number of hours worked in Japan is not obviously longer than elsewhere. Work hours, however defined, have declined in the past 20 years, albeit with considerable year-to-year variation. Conversely, the number of leisure hours has increased. The Japanese government's efforts to reduce further the paid workweek, if successful, may widen the existing gap between total hours worked by men, who work mainly for pay, and women, who are far more likely to work without pay in the home. Alternatively, the division of tasks between men and women could be altered. Whether changes in work hours and the division of labor would reduce the total number of hours worked is more problematic. A rapid move toward shorter working hours could increase the amount of unpaid labor or increase the number of people working.

The Context

Edith Cresson, the French prime minister who complained last year that Japanese employees work like ants, might be shocked to learn that Japanese historians have noted that some farming communities during the Tokugawa period, which ended 124 years ago, took 90 days off during the growing season alone. Or that 19th-century visitors to Japan were no more impressed by the Japanese work ethic. Compared to workers in their home countries, these Western visitors said, Japanese laborers appeared lazy and untutored in the requirements of a modern industrial society.

The former French leader's remarks unleashed a flurry of comment in Japan, most of it critical. Taking a somewhat different tack, Shogo Imoto, a writer for *Nihon Keizai Shimbun*, the largest Japanese economic daily, agreed with Ms. Cresson but pointed out that only 20 percent of the ants work in a typical colony.[1]

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Mr. Imoto's argument notwithstanding, most Japanese and foreign analysts hew closer to the view of Ms. Cresson than to the 19th-century visitors to Japan. A *Time*/Cable News Network poll this past February found that 94 percent of Americans believed Japanese to be competitive and hardworking; only 15 percent of the Japanese surveyed used comparable language to describe Americans. Public officials in Japan sometimes have expressed similar sentiments. In January, shortly after President Bush visited Japan, Yoshio Sakurauchi, the speaker of the Diet, reportedly claimed that American workers were not only lazy but often illiterate as well. Then in February Prime Minister Kiichi Miyazawa was interpreted as having essentially the same opinion when he argued that the American determination to "produce goods and create value has loosened sharply." Although the prime minister's comments, when viewed in context, were actually about the kinds of work Americans do rather than the work effort, they nonetheless helped fan the perception among Americans that Japanese view this country's workers as lazy.

The perception that Japanese workers are highly industrious compared to their counterparts in other economically advanced countries has important ramifications for U.S.-Japan relations. Many Americans worry that Japan simply outproduces this country. That result obviously is more likely the harder Japanese employees work. An additional American concern stems from the large trade surplus that Japan continues to have with the United States. The surplus results from the high level of savings in Japan. Since asset managers and individuals want the greatest possible return, a significant portion of these savings are directed overseas. Given the huge budget deficit and the associated high interest rates in the United States, those returns often have been in this country. The resultant demand for dollars to purchase U.S. financial assets and the supply of yen that results from the dollar demand tend to drive the value of the yen down against the dollar. As a result, Japanese exports are larger and imports lower than they would be if the savings rate were lower. Washington officials figure that if working hours were reduced in Japan, consumers there would have more opportunities to spend, thereby reducing the high household savings rate, leading in turn to a smaller outbound capital flow, a stronger yen and a smaller bilateral imbalance.

Sometimes this argument is made in a somewhat different, more intuitive way. If Japanese workers spend more time in leisure activities, they will buy more leisure-related products. As experts at leisure, this argument continues, Americans are particularly adept at producing these goods. Hence, the trade imbalance will decline as U.S. exports to Japan rise. This argument, however, inaccurately equates an expansion of U.S. exports to Japan with a decline in the trade imbalance. An increase in exports would lead to a stronger dollar, other things being equal, that would lift imports, leaving the direction of the surplus unclear. In fact, the bilateral trade imbalance is unlikely to diminish absent such macroeconomic changes as altered savings levels in both countries or changes in government spending and taxation policies.

American interest in the work/leisure issue in Japan also is stimulated by usually implicit but, as with the comments of Mr. Sakurauchi, sometimes explicit comparisons between the United States and Japan. In addition, some American analysts take a cue from the large U.S. trade deficit with Japan — and the seeming inability of American firms to compete with Japanese rivals — to conclude that average Americans make an inadequate work effort. However, this argument falters on the same grounds as the above contention that a simple increase in U.S. exports to Japan would reduce the trade deficit. A greater work effort in this country would not reduce the trade imbalance unless it were accompanied by macroeconomic policy changes in the United States, Japan or both.

The view that Americans work too little seems to run counter to an opinion that has spread in recent years — that Americans are working too hard. As described by Harvard University economist Juliet Schor, this view would seem to imply that work hours in the United States should be

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reduced.[2] Data on hours worked for pay, however, show that Americans, while putting in more hours than most of their European counterparts, work far fewer hours each year than the average Japanese worker (see Tables 1 and 2), at least in manufacturing. (For further information concerning these statistics, see *JEI Report* No. 11A, March 16, 1990, and No. 8B, February 28, 1992.) International comparisons show that more frequent holidays in Japan are more than offset by fewer weekend days off, less paid leave and fewer other absences.

As Table 2 indicates, statistics regarding hours on the job provide no clear sign that the number of hours worked in Japan is converging toward the levels that prevail in other nations.

Table 1: **International Comparison of Manufacturing Working Hours, 1989**

(in days except for total hours worked)

	Total Hours Worked	Nonwork Weekends	National Holidays	Paid Leave	Other Absence
Japan	2,159	85	20	9	3
United Kingdom	1,989	104	8	24	11
United States	1,957	104	9	19	6
France	1,646	104	8	26	16
West Germany	1,638	104	11	29	11

Source: Ministry of Labor

Table 2: **Working Hours in Japan, 1970-91***

(average hours per year)

Year	Total	Scheduled	Overtime
1970	2,239	2,039	200
1975	2,064	1,937	127
1980	2,108	1,946	162
1981	2,101	1,940	161
1982	2,096	1,939	157
1983	2,098	1,937	161
1984	2,116	1,945	171
1985	2,110	1,932	178
1986	2,102	1,930	172
1987	2,111	1,933	178
1988	2,111	1,922	189
1989	2,088	1,898	190
1990	2,052	1,866	186
1991**	2,022	1,847	175

*Based on Ministry of Labor survey of companies with 30 or more regular workers. Part-time workers are excluded from the survey, as are agricultural and forestry workers and public-sector employees.
**Preliminary.

Source: Ministry of Labor

Significantly, though, the results are influenced heavily by the business cycle, making an analysis of the trend difficult. For example, work hours declined in 1986, a recession year, as employers chose to cut back both scheduled hours and overtime. As the recovery took hold in 1987, however, work time jumped closer to the decade's peak level, reached in 1984. While the decline in hours in 1989 and 1990 in the face of continuing economic expansion is consistent with a long-run trend toward fewer hours, the continued drop in 1991 resulted at least in part from slowing economic activity. Based on data for the first three months of 1992, which show overtime hours down as much as 20 percent from a year earlier, the total number of hours well may fall again this year. Most analysts would attribute this reduction, too, to the slowdown in the economy more than to a long-run trend.

The uncertain movement in the number of working hours comes despite consistent internal pressure to reduce that figure. For example, the second Maekawa Report, released in April 1987 by a blue-ribbon panel of experts headed by former Bank of Japan governor Haruo Maekawa, stated that "an effort should be made to reduce Japanese working hours to about 1,800 hours per year as soon as possible and no later than the end of the century (as with five-day workweeks and 20 paid days off per year)" (see *JEI Report* No. 39A, October 14, 1988). On the basis of the data in Table 1 the rate of decline in labor hours between 1987 and 1991 will leave Japanese wage earners working for more than 1,800 hours even at the end of this century.

Government officials and interested trading partners are not the only ones calling for fewer hours on the job in Japan. For example, in recent years Japanese labor unions have made shorter workweeks one of their key objectives (see *JEI Report* No. 6B, February 14, 1992, and No. 13B, April 3, 1992). The unions were partially successful in the labor negotiations this spring. Among other concessions, they won a pledge from automotive makers to reduce working hours over a period of two years from the current average of 2,200 hours a year to below 2,000.

The above comparisons of hours worked say nothing, of course, about work effort during the hours people are on the job. International comparisons of productivity — which reflect individual work effort, the capital stock used by employees and other factors — continue to show American productivity to be the world's highest, particularly outside manufacturing. In February the Ministry of Labor estimated American productivity per hour worked to be 9 percent to 62 percent higher than that of Japanese workers. The wide range was attributable to the way in which prices and wages are measured. (For further details concerning productivity comparisons, see *JEI Report* No. 4A, January 31, 1992.) Numerous observers of working conditions in Japanese offices have noted that many of the extra hours devoted to unpaid overtime in such situations involve scant real work and may represent little more than waiting a socially acceptable interval before heading home.

The comparisons in Table 1 also do not take account of labor force participation rates; the average hourly figure represents time spent on the job only for those actually employed. Arguably, an American family where the husband and the wife both work 40 hours per week face a greater burden regarding work hours than a Japanese family where the husband works 60 hours per week and the wife stays at home; the statistics, however, would show that average hours worked were 50 percent higher in Japan.

Of course, both Americans and Japanese could work too hard or too long. If so, the Japanese goal ought to be significantly fewer work hours than the present U.S. level. The frantic pace of work that Harvard's Ms. Schor describes probably strikes a responsive chord with many Americans, who may find it hard to believe that, given universal human frailty, the Japanese work effort could be that much greater than theirs.

Time Allocation Studies

A recent study by two University of Michigan professors helps resolve the apparent contradiction between the image of the harried American as described by Ms. Schor and the easygoing lifestyle that the statistics in Table 1 seem to imply. In contrast to the estimated hours of work based on wages shown in Tables 1 and 2, the study by Frank Stafford and F. Thomas Juster relies on surveys in which the respondents kept diaries of how they spent their entire day — not just their paid working hours.[3]

This more comprehensive measure of how time is used is clearly relevant for assessing the diligence with which an individual — or a nation — works. In incorporating averages of the population, and not just the employed population, the Stafford-Juster data account for differing labor participation rates among nations. By including household work, the researchers allow for the real possibility that a housewife may work far harder during the course of the day than her counterpart in the paid work force.

The hours of work shown in Table 2 may not accurately reflect actual work-hour comparisons if large amounts of work are done without pay in some nations. By contrast, the Stafford-Juster approach allows for different patterns of paid and unpaid work that reflect after-tax compensation, a factor of considerable potential importance. For example, a nation with a high marginal tax rate may well find that its population opts to work fewer hours for pay. To see this idea, consider an extreme example. If the tax rate on wages were 100 percent, virtually no one would offer to work for pay inasmuch as all their wages would be taken by the state. Just to survive, the population would be forced into a pattern of self-reliance; at least one member of every household would have to learn to handle such jobs as plumber, farmer and banker. In short, high tax rates can divert labor from paid to unpaid work.

Messrs. Stafford and Juster use surveys generally taken during the 1980s in a variety of countries and make relatively modest adjustments to arrive at data that are comparable across nations. The statistics reflect the fact that labor participation rates differ by sex and nation; women average fewer hours for pay but more hours in unpaid housework in every country.[4] The results, shown in Table 3, are consistent with one of the findings from Table 1, which is that employed Japanese, particularly men, put in more hours on the job than their counterparts in the other sample countries. The top line of the table contains the most important numbers, however. When all forms of labor — including unpaid housework — are included, Japanese men work fewer hours than either Japanese women or American men. In fact, they are second only to American women among the men and the women of the six surveyed countries in the brevity of their workweek by this comprehensive measure. In other words, the study suggests that Japanese men enjoy more leisure, including time spent for personal care, than most of their colleagues in other countries.

The main explanation, of course, is housework. (Housework includes such tasks as mowing grass, doing laundry, cooking and household repairs.) According to the survey, Japanese men do very little such work, averaging 3.5 hours per week, only 39.4 percent as much as men in the Soviet Union, the next-to-lowest country on this basis. While few American wives would accuse their husbands of doing excessive work around the home, U.S. men do nearly four times as much in a typical week as their Japanese counterparts.

Among women the pattern is different. Japanese women spent 42 minutes more per week in paid employment, including commuting time, and 30 minutes longer doing housework than their American counterparts, according to Messrs. Stafford and Juster. However, the U.S. data are for 1981, the Japanese data for 1985. Rising female labor force participation rates in the United States may have pushed paid employment time per week to a level at least equal to that of Japan by 1985.

Messrs. Stafford and Juster also present data that show trends over time. On this basis Japanese men are not converging with the practices of their male counterparts elsewhere, at least not obviously. Between 1965 and 1985, the latest year for which comparable figures are available, hours at work dropped 10 percent in Japan but 15 percent in the United States. However, housework hours rose 20 percent in the United States against 25 percent in Japan. Among Danish men, by contrast, hours at work (including commuting time) dropped 20 percent, while housework increased 246 percent over the slightly longer 1964-87 period.[5] Among females, work at a paying job dropped among

Table 3: **Use of Time in Various Countries**

(hours per week)

	Japan, 1985		United States, 1981		Other Countries[1]	
	Men	Women	Men	Women	Men	Women
Activity						
Total Work	55.5	55.6	57.8	54.4	61.3	63.0
Market Work[2]	52.0	24.6	44.0	23.9	47.1	32.7
Of which: Commuting	4.5	1.2	3.5	2.0	4.0	2.6
Housework	3.5	31.0	13.8	30.5	14.2	30.3
Personal Care[3]	72.4	72.1	68.2	71.6	71.3	72.5
Leisure	40.3	40.3	41.8	41.9	35.5	32.4
Adult Education	1.2	2.2	0.6	0.4	1.2	1.5
Social Interaction	8.0	7.0	14.9	17.6	9.2	8.9
Active Leisure[4]	5.3	3.6	5.6	4.2	4.5	4.0
Passive Leisure	25.5	27.5	20.8	19.8	20.7	18.0
Of which: TV	17.3	21.4	12.7	11.5	12.0	9.7
Total	168.0	168.0	168.0	168.0	168.0	168.0

[1] U.S.S.R. (1985), Finland (1979), Hungary (1977) and Sweden (1984).

[2] Work for which one is paid and unpaid overtime.

[3] Includes eating at home, sleep and similar activities.

[4] Includes religious activities, sports and similar activities.

Source: F. Thomas Juster and Frank P. Stafford, "The Allocation of Time: Empirical Findings, Behavioral Models, and Problems of Measurement," *Journal of Economic Literature*, June 1991, p. 475.

Japanese women 26 percent while rising 26 percent among American women. Housework hours slipped a mere 1.6 percent in Japan but fell 27 percent in the United States. In short, Japanese women appeared to increasingly specialize in housework during this period, while American women were moving into the paid labor force and out of unpaid work.

The best publicized portion of work by Messrs. Stafford and Juster involved comparisons of school-age children in the United States and Japan. Both market and nonmarket work is relatively small for primary, junior high and senior high school students in both countries. The biggest difference is that Japanese students spend 72 percent more time in primary school and more than twice as much time in junior and senior high school doing school work either under a teacher's supervision at school or at home. American students spend more time on sports in all grade levels; in high school, where the difference is greatest, U.S. students spend more than 10 times as much time as Japanese students, seven hours per week versus 42 minutes per week. (The data on school-age children do not differentiate by sex.) Comparative data for college-age students are not available; however, professors and students with experience in both countries generally argue that American students attend class more frequently and work harder outside class.

College students notwithstanding, the numbers appear to suggest that Japanese children are preparing for a world of work, while American children are preparing for a world of both work and leisure. To put the matter somewhat differently, the priorities of the younger generation point toward ever-increasing Japanese international competitiveness, other factors equal, and relatively little time devoted to active leisure activities, such as sports.

While Messrs. Stafford and Juster use as their basis studies that were designed specifically to be comparable internationally, some problems remain, particularly with respect to trends over time. The demographic profile of the Japanese population underwent a considerable shift during the period in question. For example, the proportion of women aged 20 to 24 years, where labor force participation rates are highest, declined from 12.1 percent of all women in 1965 to 8.3 percent in 1985. Such demographic changes explain the apparent paradox that labor force participation rates for most age groups in Japan increased, even though the overall labor force participation rate for women dropped from 50.6 percent to 48.7 percent — apparently confirming the above result that the hours of paid employment for women declined over the 1965-85 period. The rise in participation rates in most age groups between 1965 and 1985 implies that hours of paid work per week would have increased in the absence of demographic changes.

Japanese Update: The 1990 Study

The Japanese data used in the Stafford and Juster work came from a survey conducted at five-year intervals by the state-owned Nihon Hoso Kyokai (Japan Broadcasting Corp.). In February NHK released its latest survey. While the results cannot be easily compared with the adjusted American and Japanese data cited earlier, time trends can be constructed using the original data from earlier NHK surveys.[6]

The results are shown in Table 4. As in Table 3, the numbers represent the hours and the tenths of hours spent *on average* on each activity each week, with some individuals spending far more time and others far less. (A tenth of a percent of the population claimed to have avoided sleep, with nonparticipation rates equally low for eating, but nearly 90 percent of the participants said they spent no time engaged in competitive leisure activities.) NHK's survey was based on diaries kept by 90,240 people over the age of 10 between October 15 and October 28, 1990. By comparison, the 1985 survey polled 14,400 people during the same month. NHK distributed the diaries a few days before, and collected the diaries a few days after, the survey period. The sample was constructed to be a cross section of economic groups and regions of Japan.

The table shows that time devoted to work, whether broadly or narrowly defined, did drop modestly between 1970 and 1990. Broadly defined work, for example, declined 6.7 percent. Conversely, leisure hours increased substantially but not dramatically, with the proportion of leisure spent watching television declining somewhat. By contrast, the amount of time devoted to noncompetitive sports activity increased from 24 minutes in 1970 to half an hour in 1990, a 25 percent increase. Note that the figures represent an average over the entire Japanese population older than 10 years. A relatively small part of the population spent any time at all in noncompetitive sports activities; however, those who participated in noncompetitive sports on Sunday, for example, averaged more than two hours each on that day.

The number of hours spent studying increased significantly between 1970 and 1990, a conclusion rendered more meaningful by the demographic changes that reduced the relative importance of school-age groups in the overall population. (The data do not differentiate between adult education and that of elementary, intermediate, high school and college students.) These figures suggest that the apparent trends in education-related international competitiveness mentioned above are not likely to be reversed soon.

More generally, the rates of change implied by Table 4 suggest that the international comparisons shown in Table 3 remain valid. While comprehensive data by gender are not available

Table 4: **Japan's Changing Use of Time, 1970-90**

(hours per week)

Activity	1970	1980	1990
Total Work	58.1	55.6	54.2
Paid Work	38.3	35.3	35.6
Working Hours	35.8	32.2	32.8
Commuting Time	2.4	3.0	2.9
Unpaid Work	19.8	20.3	18.6
Housekeeping	18.6	18.4	17.1
Other[1]	1.3	2.0	1.5
Student Activity	8.9	9.1	10.1
Study	7.8	8.0	9.0
Commuting Time	1.1	1.1	1.1
Personal Care[2]	74.5	76.2	73.9
Of which: Sleep	56.3	56.1	54.5
Free Time	28.0	30.7	32.1
Of which: Television	22.3	21.0	22.1

[1] Estimated. Examples include parent-teacher meetings, volunteer activities, attendance at civic group meetings and socializing with co-workers off the job.
[2] Includes sleep, meals, grooming and dressing, and inactivity for medical reasons.

Source: Compiled from data in NHK Yoron Chosa-bu (ed.), *Nihon-jin no Seikatsu Jikan* (Tokyo: Nihon Hoso Shuppan Kyokai, 1992), pp. 372-373.

for 1990, statistics differentiating ***employed*** men and women in 1990 indicate that the roles of men and women in doing housework have changed little since 1985. If anything, other evidence suggests that the division of household labor between husband and wife has become even more pronounced in the past three to five years. When workers, typically male, are transferred in Japan the wife and children sometimes stay behind, often for the assumed educational benefit of the child. The number of such *tanshin-funin* (literally, unaccompanied transfer) families increased by 30,000 between 1987 and 1990 to total 205,000, according to Ministry of Labor estimates; some evidence suggests that the actual numbers could be far higher. The MOL figure represents nearly 1 percent of all male employees and a much higher percentage of those with children. The jump between 1987 and 1990 occurred despite an increasingly tight labor market; some reports in early 1992 suggested even more such transfers could be expected this year as firms adjust to the economic downturn by relocating newly redundant workers. Whatever the reason, *tanshin-funin* shifts more of the child-rearing and housework responsibilities onto the mother and increases the hours spent on travel to and from one's home on weekends that realistically should be counted as commuting time. Not surprisingly, studies of *tanshin-funin* families have revealed high degrees of stress related to both time and money.

Implications of Japanese Leisure and Labor Choices

Whether because of the division of labor between men and women or the enormous energy devoted to study, Japanese households probably remain distinctive by international standards. Japanese men spend more hours working away from the home and fewer doing housework. The heavy burdens of maintaining the home remain on the shoulders of women far more than in other countries. The net result is that Japanese women may work harder on balance, and their husbands less hard, than their American counterparts, although the differences are small. For Japanese men and women in total, hours of paid employment are higher, and time spent on unpaid work lower, than in other industrial nations.

This division between paid and unpaid work could have several causes. One, implied above, could be the relatively low marginal tax rates on personal income in Japan. To the extent that tax cheating is widespread among some high-income individuals, actual marginal rates could be lower still. Goods and services that would be produced by households themselves in other industrialized nations may be purchased in Japan since the seller need include in the sales price only a relatively small amount to cover any ensuing personal income tax and the buyer has only a modest incentive to forgo paid employment to produce the service himself or herself. Not surprisingly, therefore, Japan has more restaurants than any other country, providing meals that would be eaten at home elsewhere. (However, since few restaurants attract families, the burden on housewives is reduced only marginally.)

The sharp division of labor between the sexes could result from sex discrimination in Japan. To the extent that wives are excluded from educational and job opportunities, their wages are lower than otherwise. A rational household could decide that the wife's unpaid work at home makes sense for the family when in the absence of such discrimination it would not have. Husbands, whose wages are inflated by sex discrimination, have an incentive to work long hours and, thus, have better excuses than their counterparts in other countries to avoid housework.

More generally, the apparent Japanese emphasis on producing and buying goods and services of high quality may result in part from labor and leisure choices. To the extent that the labor of others is cheap in an after-tax sense in Japan, consumers have an incentive to buy relatively expensive, high-quality products to minimize their own labor for repairs or time spent in the repair shop.

Similar logic also may help explain areas in which Japanese service is of poor quality. The large number of total hours worked by Japanese women may result in part from using time rather than money to procure goods and services. For example, Japanese washing machines, although inexpensive, require far more effort than those in most other industrial nations, and everyday transactions at a bank take more time; both laundry and banking are performed mainly by women in Japan. Less sex discrimination, which would make such time-consuming tasks more costly in terms of forgone wages, might improve the quality of goods and services used primarily by women.

As noted above, official policies favor reducing the paid workweek in Japan. While this move sometimes is linked with increased leisure, less of one activity does not necessarily imply more of the other. In the long run fewer hours worked mean lower real wages than otherwise. To the extent that this occurs, Japanese families will be less able to buy the goods and the services they otherwise could afford. They will have more time to obtain these goods and services with their own efforts, however. This could mean, for example, less eating out and more meals at home. It is no accident that Scandinavian countries, where paid work hours are short, are well-known for furniture that customers carry home and assemble themselves. Not surprisingly, Japanese customers up to now generally have preferred home delivery of furniture (and many other goods) despite the lofty prices that this high quality of service entails; shorter working hours could alter that preference.

In short, if working hours become significantly shorter in Japan, household tasks could increase. To the extent that the division of labor between men and women remains unaltered, the burden on women could increase. Alternatively, men could find themselves doing much more housework, as their counterparts in Scandinavia and elsewhere do. If shorter paid workweeks led to inefficient provision of services by household members rather than the skilled professionals who had provided the services in the past, the overall number of hours of paid and unpaid labor in Japan could even increase.

Japan's record over the past 20 years of less work and more leisure is a predictable consequence of its high rate of economic growth. Higher real income levels have permitted Japanese households to take part of the gain in the form of leisure — in effect, to buy leisure at the cost of forgoing some increase in wages. A shift to a significantly shorter workweek over a short period of time would have different consequences. In the absence of a jump in productivity, yearly real wages would fall and households would be forced to give up some, or all, of their gain in leisure through the purchase of a cheaper basket of goods and services; that would imply more of their own labor. When the option of fewer paid working hours is put this way, it is a much less appealing choice. Should the Japanese population nevertheless proceed down this path, it would have profound implications for relationships within Japanese households and perhaps even for the quality of Japanese goods and services.

Given these considerations, reductions in the workweek in Japan are likely to proceed slowly, as much from caution within households as from employer resistance. Even if paid employment hours were to drop, overall leisure may not increase and, with it, the opportunities for spending and dissaving that American policymakers have anticipated. In any case, patterns of work in Japan — if not the level of overall work activity — are likely to remain highly distinctive by international standards.

For further information, contact **Douglas Ostrom**.

Tooru Ando provided research assistance.

Notes

[1] Shogo Imoto, "Not All Japanese, or Ants, Really Work So Hard," Asia Foundation Translation Service Center #1552, May 4, 1992.

[2] Juliet Schor, *The Overworked American* (New York, New York: Basic Books, 1991).

[3] Frank Stafford and F. Thomas Juster, "The Allocation of Time: Empirical Findings, Behavioral Models, and Problems of Measurement," *Journal of Economic Literature*, June 1991, pp. 471-522.

[4] The data for Japan are primarily from Naomichi Nakanishi and Yutaka Suzuki, *Japanese Time Use in 1985* (Tokyo: Nihon Hoso Kyokai, 1986).

[5] Stafford and Juster, *op.cit.*, p. 477.

[6] NHK Yoron Chosa-bu (ed.), *Nihon-jin no Seikatsu Jikan* (Tokyo: Nihon Hoso Shuppan Kyokai, 1992).

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JEI

REPORT

A Two-Part Report: A and B

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Bush, Miyazawa Emphasize Solid Alliance

The official purpose of Prime Minister Kiichi Miyazawa's July 1 discussions with President Bush may have been to coordinate their strategies for the July 6-8 summit in Munich of the seven major industrial democracies as well as to explore current issues in U.S.-Japan economic and political relations. Judging by the tone of their remarks, however, it would appear that Messrs. Bush and Miyazawa were as much concerned about fostering a spirit of goodwill as they were about realizing progress on substantive issues. Unlike the two leaders' January meeting in Tokyo, which, some analysts maintain, degenerated from a summit of "high politics" to a glorified round of trade negotiations (see *JEI Report* No. 2B, January 17, 1992), the Washington talks stayed firmly on the diplomatic high road, emphasizing the strength of the bilateral alliance and the importance of continued cooperation on a broad range of international political and economic issues.

In the trade area, for example, rather than dwelling on continued frictions concerning U.S. access to the Japanese markets for motor vehicles, automotive parts and semiconductors, both leaders focused on the progress the two countries have made in realizing some of the market-opening goals outlined six months ago in the Global Partnership Plan of Action. Mr. Bush cited as reasons for optimism recent agreements to provide greater U.S. access to Japan's public-sector computer market and its paper and paperboard market (see *JEI Report* No. 3B, January 24, 1992). Accompanying the president at a Rose Garden press briefing, Mr. Miyazawa said that Japan remains committed to following up these accords.

ceiling of 1,800 hours implemented on a timetable to be worked out with Rengo (Japan Trade Union Confederation). Canon Inc. announced that its workers would be given a 16-day summer vacation beginning August 1. Nikkeiren (Japan Federation of Employers' Associations) reported that the average summer break among 183 companies surveyed is 7.5 days; since firms offering a nine-day vacation are most numerous, however, the corollary indicates that some firms are allowing very little vacation time. If working-hour concessions promised in this year's *shunto* are factored in, the average wage hike approaches 6 percent, according to a Nikkeiren spokesman.

A ceiling of 1,800 hours on the job a year since about 1987 has been a goal cited by the Ministry of Labor. The Employment Council, a ministry advisory body, recently submitted a new five-year employment policy plan that calls for a universal 40-hour workweek by the end of FY 1996. The council also recommended that the ministry raise overtime rates by an unspecified amount from the current 25 percent premium over regular wages. Tackling overtime from another angle, the Labor Ministry is moving to cut the current statutory limit of 450 overtime hours a year and is urging employers to keep annual overtime to a maximum of 360 hours. The National Personnel Authority implemented a 40-hour workweek for all central government workers in May. It also is trying to set a further example by experimenting with innovations that could improve the quality of workers' lives in other ways than a reduction of working hours. Beginning in April 1993, for example, the agency hopes to introduce flextime for 9,700 government researchers. If the change proves popular without causing disruptions, the agency may extend the policy to other government workers.

Japanese policymakers increasingly are aware that labor policy reforms are necessary to address new national goals (see *JEI Report* No. 25A, July 3, 1992). Besides directly influencing the quality of workers' lives, labor policies that give greater emphasis to time *off* the job may help boost consumer spending and so support domestic economic growth as well as raise demand for imports.

Jon Choy

Japan, United States Angle For Spot As World's Top Aid Donor

Depending on the criteria used for determining what can be considered development assistance, the United States and Japan vied with each other for the 1991 title of largest donor of foreign aid among the 20 industrialized nations that make up the Development Assistance Committee of the Paris-based Organization for Economic Cooperation and Development. Debate over whether certain types of debt forgiveness should be included in DAC members' accounts of aid disbursements clouded efforts for the second year to compare economic assistance programs (see *JEI Report* No. 38B, October 11, 1992).

DAC's Statistical Reporting Directives allow members under certain conditions to report as official development assistance the forgiveness of some non-ODA debt. Last fall DAC agreed to review the general issue of what to record as debt forgiveness after being questioned about the inclusion in members' economic assistance records of write-offs for military debt and export credits. In its June 30 ranking of ODA donors the OECD acknowledged assertions that the two types of debt forgiveness should be treated equally because the economic effects and development motivation of forgiving military debt and export credits are the same. But the organization reported that the committee had accepted a "differentiated approach" to the issue "in deference to concerns expressed over possible public opinion impacts."

DAC members concurred that in the future military debt forgiveness will be recorded but will not be included in their accounts of foreign aid disbursements; export credit cancellations will be recorded as ODA in line with current DAC statistical directives. In tallying their 1991 and 1992 ODA disbursements members will continue to follow the preliminary agreement reached last year. Under that arrangement the OECD included the non-ODA debt forgiveness reported by some members in their individual records but excluded the amounts from the DAC total. To come up with a clearer definition of foreign aid DAC members agreed to conduct a general review by mid-1994 that will include a study of current reporting practices.

This country's number-one ranking among DAC donors in 1990 was solid despite the question of whether Washington should be able to report as foreign aid $1.2 billion of military debt forgiveness for Egypt. In 1991 America's net disbursements of $11.5 billion, which included $1.85 billion in military debt cancellation for Egypt, placed it in the position of the world's top aid donor (see Table 1). Yet, excluding this debt relief from Washington's 1991 economic assistance accounts would have lowered U.S. aid disbursements to $9.65 billion, bumping this country to the number-two position behind Japan, which reported disbursements of nearly $11 billion last year. (Japan's total included $7 million of export credit forgiveness.)

Table 1: **ODA of Major Donor Countries**, 1987-91

(in millions of dollars; net disbursements)

1991 Rank	Country	1987	1988	1989	1990	1991[1]	Share of Total DAC ODA 1991[1]
1	United States	$8,945	$10,141	$7,676	$11,394	$11,496	19.7%
2	Japan	7,342	9,134	8,965	9,069	10,951	18.8
3	Germany	4,391	4,731	4,948	6,320	6,769	11.6
4	France[2]	4,489	4,777	5,162	6,579	6,663	11.4
5	United Kingdom	1,871	2,645	2,598	2,638	3,248	5.6
6	Italy	2,615	3,193	3,613	3,395	2,865	4.9
7	Canada	1,885	2,347	2,320	2,470	2,578	4.4
DAC Total[3]		41,426	48,132	46,723	55,146	58,247	100.0

[1] Preliminary.
[2] Excluding overseas departments and territories.
[3] The 1991 total includes France's overseas departments and territories but excludes disputed amounts.

Source: Organization for Economic Cooperation and Development

Japan's 1991 net disbursements of nearly $11 billion reflected a 20.8 percent increase from the year-earlier level. In yen terms the gain worked out to a 12.2 percent rise. With adjustments for price changes and the yen-dollar exchange rate, Japan's total foreign aid grew 10.1 percent in real terms last year. All of this increase was attributable to a 19 percent rise in bilateral disbursements; multilateral net disbursements fell compared to the previous year due to the timing of Japan's contributions to multilateral organizations, the OECD reported. Bilateral grant assistance grew by less than 1 percent in 1991, while loans expanded 32 percent in real terms. Earlier in June Tokyo had attributed the significant increase in lending largely to the emergency loans extended to countries on the front line of Iraqi action during the 1990-91 Persian Gulf War.

In recognition of this growth in real net disbursements the OECD's foreign aid report highlighted Japan as the main force behind DAC's expanded economic assistance in 1991. Most DAC members increased their foreign aid in real terms, the OECD reported, citing steady growth in the volume of aid extended by DAC nations over the past five years. DAC members' overall net disbursements to developing countries and multilateral institutions totaled $58.2 billion in 1991, up 5.6 percent in nominal terms and 2.1 percent in real terms.

Table 2: **ODA as Percentage of GNP for DAC Countries, 1987-91**

(in millions of dollars; net disbursements)

1991 Rank		1987 Amount	1987 Percent of GNP	1988 Amount	1988 Percent of GNP	1989 Amount	1989 Percent of GNP	1990 Amount	1990 Percent of GNP	1991[1] Amount	1991[1] Percent of GNP	Percent Change 1990-91[1]
1	Norway	$890	1.09%	$985	1.13%	$917	1.05%	$1,205	1.17%	$1,178	1.14%	-2.3%
2	Denmark	859	0.88	922	0.89	937	0.93	1,171	0.94	1,204	0.96	2.8
3	Sweden	1,375	0.88	1,534	0.86	1,799	0.96	2,007	0.91	2,126	0.92	5.9
4	Netherlands	2,094	0.98	2,231	0.98	2,094	0.94	2,538	0.92	2,517	0.88	-0.8
5	Finland	433	0.49	608	0.59	706	0.63	846	0.63	930	0.76	9.9
6	France[2]	4,489	0.51	4,777	0.50	5,162	0.54	6,579	0.55	6,663	0.56	1.3
7	Canada	1,885	0.47	2,347	0.50	2,320	0.44	2,470	0.44	2,578	0.45	4.4
8	Belgium	687	0.48	618	0.39	703	0.46	889	0.46	820	0.41	-7.8
9	Germany	4,391	0.39	4,731	0.39	4,948	0.41	6,320	0.42	6,769	0.40	7.1
10	Australia	627	0.34	1,101	0.46	1,020	0.38	955	0.34	1,055	0.38	10.5
11	Austria	201	0.17	301	0.24	282	0.23	394	0.25	546	0.34	38.7
12	Japan	7,342	0.31	9,134	0.32	8,965	0.31	9,069	0.31	10,951	0.32	20.8
13	Switzerland	547	0.31	617	0.32	558	0.30	750	0.32	767	0.32	2.3
14	United Kingdom	1,871	0.28	2,645	0.32	2,598	0.31	2,638	0.27	3,248	0.32	23.1
15	Portugal[3]	--	--	--	--	--	0.24	148	0.25	190	0.28	28.3
16	Italy	2,615	0.35	3,193	0.39	3,613	0.42	3,395	0.31	2,865	0.25	-15.6
17	New Zealand	87	0.26	104	0.27	87	0.22	95	0.23	93	0.23	-2.0
18	Spain[3]	--	--	--	--	--	0.14	959	0.20	1,177	0.23	22.7
19	United States	8,945	0.20	10,141	0.21	7,676	0.15	11,394	0.21	11,496	0.20	0.9
20	Ireland	51	0.19	57	0.20	49	0.17	57	0.16	73	0.19	27.3
DAC Total[4]		41,426	0.34	48,132	0.36	46,723	0.34	55,146	0.34	58,247	0.34	5.6

[1] Preliminary.
[2] Excluding overseas departments and territories.
[3] Portugal and Spain joined DAC in December 1991.
[4] The 1991 total includes France's overseas departments and territories but excludes disputed amounts.

Source: Organization for Economic Cooperation and Development

Yet the latest OECD figures show that ODA as a percentage of DAC members' combined gross national product did not improve from 1990's level of 0.34 percent (see Table 2). Norway, Denmark, Sweden and the Netherlands again achieved the highest ODA/GNP ratios. Japan's ODA/GNP figure increased 0.01 percentage point to 0.32 percent. On this basis Japan tied for 12th place with Switzerland and the United Kingdom. U.S. aid as a share of GNP narrowed slightly from 0.21 percent to 0.20 percent, keeping this country in the second-to-last place on the ODA/GNP scale.

The same day that the OECD outlined DAC members' aid performance in 1991 the Japanese cabinet approved an initiative intended to increase understanding of official development assistance in Japan and abroad and to improve implementation of Tokyo's program. Submitted by the Ministry of Foreign Affairs, the charter outlines the philosophy, principles and priorities underlying Japan's foreign aid program.

In describing the basic philosophy of Japan's economic assistance program the document reaffirms certain elements previously emphasized in that country's approach to foreign aid, including the need to recognize interdependence among nations and the importance of bolstering self-sufficiency in developing countries. The charter states that, among other factors to be taken into account, Japan's official development assistance will be provided in accordance with four principles. In part the principles incorporate guidelines announced a year ago (see *JEI Report* No. 16B, April 26, 1991); these called on the government to consider both the military and the political policies of a recipient country before providing aid. Reiterating the earlier guidelines, the charter states that "full attention" should be paid to a recipient nation's efforts to promote democratization and to introduce a market-oriented economy as well as to conform to accepted human rights policies. Similarly reinforcing the previous guidelines is the principle that full attention will be paid to "trends in recipient countries' military expenditures, their development and production of mass destruction weapons and missiles," and their arms trade. A third principle further emphasizes: "Any use of ODA for military purposes or for aggravation of international conflicts should be avoided." A fourth principle notes, "Environmental conservation and development should be pursued in tandem."

The charter follows former aid policies in assigning priorities to Asian countries and to helping to improve infrastructure, "which is a prerequisite to socioeconomic development." The charter further notes that Japan will provide assistance for basic human needs and will place an emphasis on bolstering human resource development. The document also outlines steps Tokyo intends to take to ensure more effective implementation of its economic assistance program and greater public understanding of, as well as participation in, aid efforts.

The new ODA charter is based on suggestions made by a subcouncil of the latest administrative reform council, an ongoing effort to streamline Japanese government operations (see *JEI Report* No. 45A, December 6, 1991, and No. 3A, January 24, 1992). The group examining "Japan and the World" last year recommended the drafting of a document that sets out Japan's fundamental ODA policy as a way of increasing support for and understanding of the country's economic assistance efforts. Some Japanese officials characterize the ODA charter as the key recommendation to emerge from the subcouncil, which was assigned to examine the overall conduct of Japan's foreign policy. While some observers may call for further restructuring of Japan's foreign aid program, certain sectors of the Japanese public seem likely to welcome the new ODA document. Keidanren (Japan Federation of Economic Organizations), for one, roughly two years ago proposed an ODA charter "to state clearly the Japanese government's basic position, ideas, objectives, and future goals" concerning foreign aid. Critics of Japan's aid program long have contended that Tokyo needed to clarify the philosophy behind its expanding economic assistance efforts. The new charter may hold some of these criticisms at bay.

Margo Grimm

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JEI

REPORT

A Two-Part Report: A and B

NO. 27A

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NEW STRAINS IN JAPAN-SOUTH KOREA ECONOMIC RELATIONS

SUMMARY

South Korea's extraordinary economic advances during the last three decades or so have been described as following a flying-geese pattern of development. Learning from Japanese experiences during the postwar economic reconstruction period, the government in Seoul adopted policies promoting specific export-oriented industries. Recently, however, the South Korean economy has begun to lose the advantages of being a latecomer. National income is approaching the level achieved by industrial economies. Moreover, the rapid rise in the wages of South Korean workers has eroded the low-cost advantage key to international competitiveness in labor-intensive industries.

A triangular relationship with the United States, both as a buyer and a supplier, and Japan, primarily as a provider of capital goods and technology, has facilitated South Korea's economic catch-up. South Korea's economic growth, however, not only has altered internal expectations — for higher wages and salaries, for example — but similarly has resulted in revised external expectations. Washington, pressed by American manufacturers affected by competition from South Korean products, no longer views South Korea as a developing economy and has urged Seoul to liberalize domestic markets and protect intellectual property rights more effectively. Tokyo, for its part, has experienced the changes in the South Korean economy from a perspective different from Washington's, at times finding itself the target of complaints over Japanese trade practices and at other times leveling charges of unfair trade practices against Seoul.

Economic talks between Tokyo and Seoul have focused on enlarging South Korea's exports to Japan and facilitating transfers of Japanese industrial technologies. But trade is not the only stumbling block to improved bilateral relations. To some extent a gap exists between Japanese and Korean views of one another — the outgrowth of a complicated, long-term Tokyo-Seoul political relationship and ethnic rivalry between the two nations.

South Korean Economic Development

South Korea's economic expansion has been so extraordinarily rapid over the past three decades that the country has been named one of East Asia's Four Tigers along with Hong Kong, Singapore and Taiwan. Except for the period between 1977 and 1981 real economic growth averaged between 7.8 percent and 10 percent annually, a pace that exceeded the targets projected in Seoul's five-year economic plans (see Table 1). In 1991 South Korea had a per capita gross national product of $6,300; by 1996, when the current five-year plan ends, the government expects the country's GNP per person to exceed $10,000. The 1992-96 plan envisions the economy increasing at what for South Korea is the relatively moderate inflation-adjusted rate of 7.5 percent a year. Growth on that order, however, is far faster than that anticipated for developed economies. The economies of the 24 member countries of the Organization for Economic Cooperation and Development are projected to expand by an average 1.8 percent in real terms this year and by 3 percent in 1993. Japan's recently released FY 1992-FY 1996 economic plan puts real GNP growth slightly higher than the OECD average at 3.5 percent a year. Some analysts have the same doubts about South Korea's ability to achieve its growth target as they do about Japan, but South Korea's advances to date have led many observers to expect the OECD to admit that country as a member before the end of this century.

Table 1: **Growth Target and Performance under South Korea's Five-Year Economic Plans**

Plan	Period	Planned Real GNP Growth	Actual Real GNP Growth
First	1962-1966	7.1%	7.8%
Second	1967-1971	7.0	9.6
Third	1972-1976	8.6	9.7
Fourth	1977-1981	9.2	5.8
Fifth	1982-1986	7.5	8.6
Sixth	1987-1991	8.2	10.0
Seventh	1992-1996	7.5	n.a.

Source: Republic of Korea, Economic Planning Board

South Korea's economic success has been attributed in part to the fact that Japan's postwar economic reconstruction provided a development model for Seoul. Despite differences between the island nation and the peninsular nation, the two East Asian countries share a similar cultural heritage and economic environment. Both, for example, are densely populated and poor in natural resources. A deep respect for education has contributed to the emergence of a well-educated work force. The need to import industrial and agricultural inputs, combined with their human-resources endowments, led to the development of export-oriented industries in both countries. Like Japan's Ministry of International Trade and Industry, South Korea's Ministry of Trade and Industry has implemented policies to foster specific industrial sectors. In historical order these have included textiles, shipbuilding, steel, motor vehicles and electronics. Domestic entrepreneurs organized *keiretsu*-type conglomerates, such as Samsung, Hyundai and Goldstar, that have benefited from the government's industrial promotion initiatives. The Korea Development Bank and the Export-Import Bank of Korea have provided financial assistance to targeted industries, much as Japan's government-owned banks

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did. The Korea Trade Association, like the government-affiliated Japan External Trade Organization, has helped the business community improve sales in overseas markets. Since South Koreans and Japanese share common Confucian values, the Korean people had little difficulty in following the Japanese pattern of capitalism, in which the government plays a leading role in guiding the private sector's activities. In fact, the linkage between the government and the private sector in South Korea has been even stronger than has been the case in Japan.

The United States and Japan, the two leading economies in the Pacific region, facilitated South Korea's economic development. Apart from providing military security through the stationing of U.S. forces in South Korea, Washington gave relatively substantial amounts of foreign aid to Seoul until the mid-1980s. Moreover, American firms invested money in South Korea and transferred technology to that country, while the U.S. market absorbed a significant part of South Korea's expanding output of manufactured goods.

For its part Tokyo provided $504 million in grants and nearly $2.6 billion in yen loans on concessional terms to Seoul between 1965 and 1990, initially as compensation for Japan's colonization of the Korean peninsula between 1910 and 1945. Although by 1984 South Korea's per capita GNP had reached $2,000 — regarded as the upper limit of eligibility for concessional yen loans, Tokyo lent Seoul $1.85 billion between 1983 and 1990 in line with an agreement reached in January 1983 between then Prime Minister Yasuhiro Nakasone and then President Chun Doo Hwan. During the 1983-91 time frame Japanese companies hosted more than 1,000 South Korean technicians under a government-sponsored special training program also initiated by Messrs. Nakasone and Chun. Together with the financing and the technical cooperation extended by Japan's private sector, this assistance further helped to accelerate South Korea's economic development.

Hard work, the benefits of latecomer status, outside assistance and an effective industrial policy have brought South Korea's economy close to the level of a developed economy. In 1990 South Korean companies invested more overseas than foreign firms put into South Korea. In another sign of the country's new economic status Seoul established the Economic Developing Fund in 1987 and the Korea International Cooperation Agency in 1990 to provide financial and technical assistance to developing countries. The 1988 Summer Olympic Games impressed both a worldwide television audience and those attending in Seoul that South Korea no longer was a developing nation, Korean observers point out.

Economic Policy Pressures

When South Korea's standard of living was relatively low government officials felt they could ask citizens to be patient until the nation's economic pie grew large enough to share the benefits. Rapid economic growth, however, resulted in increasing demands for the immediate betterment of people's lives as well as sweeping political reform. The dramatic democratization initiatives unveiled by President Roh Tae Woo before he assumed office in February 1988 gave momentum to the labor movement's push for better living conditions through higher wages. Helped by the labor shortages caused by the construction boom before the 1988 Seoul Olympics, this campaign succeeded. Between 1985 and 1990 the average South Korean worker's wages soared 2.19 times.

Not surprisingly, productivity gains in the manufacturing sector did not keep pace with the jump in pay. The inevitable result — a decline in the international competitiveness of South Korea's labor-intensive industries — undercut the government's industrial policy with its emphasis on maintaining the cost edge of domestically made products in world markets. The rapid growth in domestic consumption — especially of cars and consumer electronics products like televisions, which, at least through 1991, were South Korea's major export items — also raised questions among South Korean government officials and businessmen alike about the wisdom of the country's export-oriented growth strategy. At the same time the interests of South Korean business leaders were changing, shifting from government protection and promotion of export-oriented industries to more freedom to conduct business at home. Various analysts have suggested that the bid of Chung Ju Yung, the founder of the Hyundai conglomerate, in the presidential election to be held late this year represents the private sector's dissatisfaction with the government's top-down style of economic management.

Pressure from Washington also is forcing Seoul to reconsider its economic policies. Although the share of South Korea's worldwide exports going to the United States dropped to about 25 percent in 1991 from 40 percent just five years earlier, this country still is the biggest foreign customer for Korean-made products. The majority of South Korea's U.S.-bound shipments consist of labor-intensive manufactures, such as electronic products, textiles and footwear, but over the last decade or so exports of steel, cars and other high value-added products have expanded rapidly. South Korean purchases from the United States are made up mainly of agricultual commodities, chemicals and machinery.

Until 1982 South Korea-U.S. trade was almost in balance. Starting the following year, however, South Korean exports to this country began climbing, while purchases of American-supplied goods remained relatively flat. By 1987 South Korea was running a $9.6 billion surplus in trade with the United States. The fast-expanding bilateral surplus contributed to an improvement in South Korea's overall trade account, which had been in the red until 1985 but was $10 billion in the black in 1988.

The surge in South Korean exports to the United States triggered several predictable responses from this country. Over the past decade, for example, a series of antidumping cases initiated by American manufacturers confronted with the market inroads of their South Korean competitors has resulted in penalty duties on various Korean exports, like color television sets, small business telephone systems, sweaters and photo albums. Major South Korean exporters also have been targets of industry-propelled U.S. drives for voluntary restraint agreements, orderly marketing agreements or other limits on competition from made-in-South-Korea products, starting with textiles and apparel in 1965 and including steel (1984) and machine tools (1986). Moreover, Washington "graduated" South Korea in 1989 from eligibility for duty-free tariff treatment under the Generalized System of Preferences.

While continuing to protect U.S. trade interests at home, the Bush administration has put increasing emphasis on expanded market opportunities in South Korea for American exporters of goods and services. Capitalizing on Seoul's worries that South Korea would be named a priority country for market access negotiations under the Super 301 provision of the 1988 Omnibus Trade and Competitiveness Act, U.S. trade negotiators won concessions in the spring of 1989 on a long list of goods of export interest to American companies. Seoul agreed to remove the quantitative import restrictions on 243 agricultural commodities and 30 manufactured products by July 1991. The government also promised to reduce the average tariff on farm goods to 7.9 percent in 1994 from the 1989 average of 12.7 percent and to trim the duties on manufactures from 11.2 percent on average to 6.2 percent over the same period.

As part of the negotiations that kept South Korea off the 1989 Super 301 list, Seoul agreed to modify its Foreign Capital Inducement Act in 1991 to reduce the restrictions on inward foreign investment. Requirements covering local content, technology transfers and local equity participation, among others, were lifted or modified. As of this year, for example, foreign investors can own up to 10 percent of the shares in a publicly traded South Korean company. In 1989 as well the South Korean government said it would strengthen enforcement of intellectual property protection, which Washington had cited as an area of concern when it placed South Korea on the priority watch list under the Special 301 provision of the 1988 trade act.

Since 1988 South Korea-U.S. trade has moved dramatically toward a balance. According to the statistics compiled by Seoul, South Korea had a $300 million or so trade deficit with the United States in 1991. (Department of Commerce figures indicated, however, that this country ran a $1.5

billion deficit in bilateral trade last year, although that number was far below the $8.9 billion gap between exports and imports posted in both 1987 and 1988.) South Korea's imports of U.S. goods more than doubled between 1987 and 1991, while its exports to this country remained between $18 billion and $20 billion a year.

Although the market opening steps taken by Seoul and the trade-restrictive actions implemented by Washington contributed to the reduction in the South Korea-U.S. trade imbalance, most economists give primary credit for the reduced surplus to the post-1985 appreciation of the Korean won against the dollar. From an average of 870.02 won=$1.00 in 1985 the value of the South Korean currency rose to 671.46 won to the dollar in 1989, a 29.6 percent realignment, before retreating to 733.35 won=$1.00 in 1991. A number of analysts have suggested as well that the stumbling performance of the U.S. economy and South Korea's continuing economic boom have had an impact on transpacific trade flows. Whatever the ranking of these factors, the reduction in South Korea's trade surplus with the United States played a part in the return of red ink to that country's overall trade account in 1990. Last year South Korea's worldwide trade deficit totaled $9.7 billion.

Japan-South Korea Trade and Investment Relations

No small part of that imbalance was related to South Korea's trade with Japan. According to Japanese statistics, Japan's perennial trade surplus with its neighbor hit a record $7.7 billion in 1991, more than double the recent low of $3.6 billion registered in both 1988 and 1989. Many economists have pointed out that the chronic bilateral trade imbalance stems from South Korea's heavy dependence on Japanese suppliers for parts and components. Equally important, they say, are the difficulties that South Korean manufacturers have in selling in Japan, especially where there is strong domestic competition.

Japan has been South Korea's leading supplier of both machinery and parts since the two countries established diplomatic relations in 1965. The priority that Seoul's economic development game plan put on fostering consumer goods industries resulted in South Korean manufacturers turning to Japanese suppliers for machine tools and other production equipment as well as components and parts. As South Korea's export drive geared up in the 1980s, purchases of Japanese-made machinery and parts increased almost in tandem. While the share of textiles and apparel, chemicals, and metals and fabricated metal products in Japan's exports to South Korea decreased gradually during that decade as South Korean industry became competitive in these product areas, the relative importance of capital goods increased. Last year capital goods made up roughly 60 percent of Japan's South Korea-bound shipments (see Table 2).

Even though Japan consistently sells more to South Korea than it buys, Japanese exporters have market access complaints of their own. Automotive and consumer electronics products, Japan's top overall exports, have made only limited inroads in the South Korean market. This is due mostly to import restrictions. As part of its strategy to protect domestic makers of motor vehicles, consumer electronics goods and some other products, Seoul has required since 1980 that exporters in the country with which South Korea has recorded the largest bilateral trade deficit over a certain period get special permission to ship in about 250 items. The stated goal of this program is to help diversify South Korea's sources of supply. Initially, the prior year's trade data were used to determine which country's exporters won the dubious distinction of being subjected to this treatment. Japan was so identified between 1980 and 1982. However, in 1983 after South Korea reviewed the previous year's largest bilateral trade deficit, which was with Saudi Arabia, the rules suddenly were changed. Under the new regulations, which base each year's determination of the affected country on the previous five years of trade figures, Japanese suppliers have continued to be targeted for import restrictions. A report on foreign unfair trade policies and practices issued in June by MITI's Industrial Structure Council suggested that Seoul's country-targeted import restrictions violate the antidiscrimination rules of the General Agreement on Tariffs and Trade (see *JEI Report* No. 23B, June 19, 1992).

Table 2: **Composition of Japan's Exports to South Korea, 1976-91**

(share of total exports)

	1976	1981	1986	1991
Food	0.1%	6.0%*	0.1%	0.5%
Textiles and Apparel	10.8	6.2	5.0	3.6
Chemicals	18.1	14.8	13.2	13.0
Nonmetallic Mineral Products	1.0	1.9	2.2	2.0
Metals and Fabricated Metal Products	19.5	17.6	13.5	11.4
Machinery and Transport Equipment	37.6	40.6	57.8	60.5
Nonelectric Power Generating Machinery	1.6	2.9	2.1	2.1
Computers and Other Office Machines	0.6	0.8	4.1	2.8
Metalworking Machinery	2.8	1.3	3.9	4.3
Textile Machinery	4.1	2.3	1.6	2.7
Electric Power Generating Machinery	1.5	2.4	2.9	2.1
Electronic Tubes and Semiconductors	2.8	4.6	7.3	8.7
Television Sets and Radio Receivers	1.0	0.4	0.3	0.2
Videocassette and Tape Recorders	0.5	0.5	0.7	0.3
Scientific and Medical Equipment	1.4	1.7	2.0	2.7
Motor Vehicles	0.3	0.5	0.2	0.6
Other	12.8	12.7	8.3	9.0
Total	100.0	100.0	100.0	100.0
Total Exports (in millions of dollars)	$2,824	$5,658	$10,475	$20,068

*Includes rice shipped as food aid.

Source: Japan Tariff Association

Although South Korean products do not encounter similar trade barriers in Japan, South Korea's exporters complain about the problems of selling there. Most of the products exported by South Korean industry compete with made-in-Japan products, and that has limited their penetration of the Japanese market. Textiles and clothing, especially low-cost goods, have won relatively large shares of the Japanese market. Japan's imports of steel from South Korea, particularly commodity products in which Japanese mills are at an increasing cost disadvantage, also have expanded rapidly (see Table 3), but Japanese manufacturers generally have reacted warily to stepped-up competition from South Korean rivals. Japanese knitwear makers, for example, asked Tokyo in 1988 to negotiate a VRA with Seoul limiting shipments over the 1989-91 period (see *JEI Report* No. 26A, July 7, 1989). Moreover, South Korean government officials and businessmen often have complained about the comparatively high tariffs and/or nontariff barriers affecting imports of textiles, leather, footwear, toys, agricultural commodities and fish products from their country.

As indicated above, however, the frustrations are not one-sided. Moreover, they encompass not only Seoul's trade policies but also its continuing restrictions on foreign direct investment, particularly in the manufacturing sector. Reflecting the protectionism in this area, Japan's direct investment in South Korea is relatively small compared with the amount of money Japanese investors have put into other Asian countries. As of March 1992 Japan's cumulative direct investment in South Korea amounted to $4.4 billion, well below the comparable totals for Indonesia ($12.7 billion), Hong Kong ($10.8 billion), Singapore ($7.2 billion) and Thailand ($5.2 billion).

Table 3: **Composition of Japan's Imports from South Korea, 1976-91**

(share of total imports)

	1976	1981	1986	1991
Food	23.2%	19.8%	21.8%	12.5%
Textile Fibers	1.3	0.2	0.2	0.1
Metal Ores and Scrap	1.2	0.4	0.2	0.2
Other Raw Materials	4.6	2.7	2.8	2.0
Mineral Fuels	3.9	2.8	5.6	4.2
Chemicals	2.8	7.8	6.1	5.0
Textiles and Apparel	35.5	30.2	24.4	23.7
Steel	1.0	11.3	9.5	13.3
Nonferrous Metals	0.4	0.6	0.5	0.6
Machinery and Transport Equipment	13.5	11.2	12.6	18.5
Toys and Games	0.2	0.2	0.6	0.9
Other	12.4	12.7	15.7	19.0
Total	100.0	100.0	100.0	100.0
Total Imports (in millions of dollars)	$1,917	$3,389	$5,292	$12,339

Source: Japan Tariff Association

Bilateral Trade Talks

Criticism in South Korea of its year-in and year-out trade deficit with Japan was relatively mild during the late 1980s when the country had a surplus in its overall trade account. That has changed in the 1990s. Whenever government-level or private-sector talks are held, the main topic of discussion regardless of its position on the agenda inevitably is the bilateral trade imbalance. The January 1992 summit meeting of Prime Minister Kiichi Miyazawa and President Roh in Seoul was no exception. Although a variety of political and economic matters surfaced, the chronic South Korea-Japan trade gap dominated the talks (see *JEI Report* No. 3B, January 24, 1992). This issue had become even more critical from the host nation's perspective because South Korea's trade deficit with Japan had widened in 1991 despite a promise by Mr. Miyazawa's predecessor, Toshiki Kaifu, during his 1990 visit to Seoul to devise measures to narrow the bilateral trade imbalance.

South Korean participants in the talks left no doubt about which country's policies and practices they thought were responsible for the expanding bilateral trade imbalance. The Roh delegation characterized as reasonable its request for action by the Japanese government on tariffs, nontariff trade barriers and structural impediments to expanded sales of South Korean products in Japan, arguing that Tokyo should be as responsive to calls for improved market access from Japan's number-two trading partner as it had been in dealing with similar demands from the United States. The South Korean side also left no doubt that it expected Tokyo to persuade the Japanese business community to help expand imports from South Korea — for example, by asking trading houses and big manufacturing companies to draft plans to increase purchases of Korean-made products.

Japanese officials attending the Miyazawa-Roh meeting reacted coolly to Seoul's call for action. In stressing that many of the problems identified by South Korea had to be resolved by the private sector, the Japanese participants appeared to dismiss the idea of the government pushing companies to come up with plans to buy more South Korean goods. Japanese officials' response reflected the view in Japan's business community that Seoul's proposal was unwarranted since Japanese exporters' access to the South Korean market is restricted. At the same time, though, the

Japanese side promised to support expanded business transactions through the joint trade promotion activities of JETRO and the Korea Trade Association. Seoul also made no headway on its request for lower duties on 16 goods of particular interest to South Korean exporters, with the Miyazawa administration indicating that no duty cuts would be implemented pending conclusion of the Uruguay Round of multilateral trade negotiations.

Seoul also received little positive feedback on another issue high on its agenda for the Miyazawa-Roh talks — the transfer of advanced Japanese technologies. The South Korean government regards help of this type as a long-term solution to the bilateral-trade imbalance since access to sophisticated Japanese product and process know-how would improve the competitiveness of Korean products in Japan and reduce South Korean industry's heavy dependence on Japanese suppliers of capital equipment, such as machine tools. Technology transfer, however, is a difficult issue for Tokyo since most of the know-how that South Korean manufacturers want belongs to Japanese companies. Japan concluded 1,829 technology licensing deals with South Korea from 1985 to 1990 (see Table 4). Although that number represented almost half of the technology transfers from all countries to South Korea, the royalties and other fees received by Japan equaled just 31 percent of what South Korea paid out in total. Referring to that fact, South Korean government officials and businessmen often have complained that Japanese companies are willing to license only older-generation technology.

Table 4: **International Technology Transfers to South Korea, 1985-90**

(in millions of dollars and number of cases)

Source		1985	1986	1987	1988	1989	1990	Total 1985-90
Total	Value	$296	$411	$523	$676	$930	$1,087	$3,923
	Cases	454	517	637	751	763	738	3,860
Japan	Value	$75	$130	$181	$215	$274	$341	$1,216
	Cases	228	264	307	354	343	333	1,829
United States	Value	$155	$192	$240	$330	$416	$514	$1,847
	Cases	114	157	180	200	244	221	1,116
West Germany	Value	$12	$19	$19	$22	$53	$59	$184
	Cases	29	23	34	49	37	55	227

Source: Republic of Korea, Ministry of Finance

To facilitate technology transfers from Japan to South Korea President Roh proposed at his January meeting with Prime Minister Miyazawa that a foundation be set up for this specific purpose. That organization would collect data on which companies in Japan had technologies appropriate to South Korea's requirements and then make this information available to South Korean companies. If necessary, the foundation would provide financial help to South Korean firms to acquire Japanese technology. Of the estimated $200 million needed to establish the foundation, Seoul suggested that the Japanese side fund 75 percent.

The Japanese delegation reportedly not only ruled out government funding for the proposed institute, arguing in part that South Korea no longer qualifies for foreign aid, but also said the technology transfer issue, in principle, should be handled by the two countries' business communities. Leading Japanese corporate executives agree that the decision to transfer technology, particularly the sophisticated know-how sought by South Korean competitors, should be based on commercial factors rather than political considerations. They contend, however, that inadequate South Korean protection of Japanese intellectual property rights, including patent claims, is a major disincentive to licensing the cutting-edge know-how sought by companies in South Korea. While Seoul has allowed American and European companies to apply for patents on products as well as processes since 1987 and 1991, respectively, Japanese manufacturers still are limited to process patents.

Despite the multiple reservations of Japanese government officials and business leaders about Seoul's proposals for action on the trade and technology transfer fronts, Prime Minister Miyazawa agreed during his January talks with President Roh that the two countries would develop a package of measures by the end of June. Those initiatives were released June 30 by each country's foreign ministry. The most concrete part of the program is a plan for each country's private sector to set up a separate foundation capitalized at ¥1 billion ($7.4 million at ¥135=$1.00) to facilitate technology transfers. The specific activities of the planned institutes were not identified, but they are expected to undertake such projects as organizing information-gathering missions and exchanging trainees; these activities reportedly will be subsidized in part by Tokyo and Seoul. The two governments agreed as well to initiate talks in July on stronger South Korean protection of Japanese intellectual property rights. Ministry of Foreign Affairs officials say they hope these discussions can be wrapped up by the end of the year. Tokyo also noted in the package the possibilities for South Korean participation in government-sponsored international research and development projects, such as the Intelligent Manufacturing System and the Human Frontier Science Program (see *JEI Report* No. 36A, September 27, 1991), indicating that this was another avenue for technology transfer.

The action plan is short on trade-specific steps. One of the few is the creation of a new forum to enable Japanese and South Korean business leaders to discuss a variety of trade problems. Seoul also said it would allow Japanese trading companies to deal directly with South Korean customers and to handle overseas trade of Korean-made products to Japan or third countries, thereby addressing one long-standing Japanese complaint about restrictions on business activities in that country.

Bridging the Perception Gap Affecting Japan-South Korea Relations

Recent talks between Tokyo and Seoul have highlighted the perception gap that divides the two countries, a divergence that mostly stems from historical rivalry and a complicated political history. Going far back in time, either the Japanese or the Koreans have assumed a superiority over their neighbors. More recently Japanese have tended to claim that their country's economic success induced South Korea's economic development. By copying the Japanese style of capitalism, South Korea had a relatively easy time catching up with developed economies, this argument goes.

South Koreans, on the contrary, suggest that Japan's economic success has been achieved at the expense of the Korean people. They say Koreans were sacrificed for Japan not only during that country's 1910-45 occupation of their homeland but even after World War II. The Korean War, for example, stimulated demand for Japanese-made products, thereby helping to accelerate Japan's economic development. Moreover, it is argued, while South Korea continued to be on the front line against the expansion of Communist powers and spent considerable amounts of money on defense — a benefit to countries like Japan, Japan earmarked most of its financial resources for economic development and spent little on security. For these reasons South Koreans feel justified in asking Japan to take responsibility for the bilateral trade imbalance, viewing it as compensation for past experiences and more recent "debts."

The memories and the after-effects of Japan's occupation of the Korean peninsula still impede confidence building on both sides. Although the 1965 Treaty on Basic Relations resolved the issue of compensation at the government level for Japan's occupation, many Koreans do not consider that Japan has made up fully for its past transgressions. In the last five years alone many issues related to the Japanese occupation have been raised by the South Korean government, including: Tokyo's requirement that Korean residents in Japan, including those born from conscripts brought to Japan before and during World War II, be fingerprinted; compensation for Koreans now living in their homeland who suffered from the atomic bombs dropped on Hiroshima and Nagasaki; the return of Korean cultural artifacts taken or bought by the Japanese during the occupation; assistance to reunify Korean families separated when some family members were forced to move by Japanese authorities to Sakhalin Island, which Japan ruled before the end of World War II; and compensation for "comfort ladies" — Korean and other women whom the Japanese military put in brothels to serve as prostitutes for Japanese soldiers (see *JEI Report* No. 2B, January 18, 1991, and No. 3B, January 24, 1992). Moreover, the surprise visit to North Korea in 1990 by Shin Kanemaru, an influential member of Japan's ruling party, upset Seoul (see *JEI Report* No. 40B, October 19, 1990). Many South Koreans also suspect that Tokyo's enactment of a measure that allows its Self-Defense Forces to participate in international peacekeeping operations sponsored by the United Nations might lead to renewed militarism in Japan.

Political issues like these have a way of complicating economic negotiations. Many analysts point to the precedent for linking politics with economics by citing Prime Minister Nakasone's 1983 decision to make loans on concessional terms available to South Korea, even though that country was on the verge of moving out of the developing-nation category. Yet, without resolving the political problems, the trade and other economic problems straining the Japan-South Korea relationship will be difficult to rectify. Political issues often seem to be raised by both countries when economic relations worsen. Since the Asian Pacific region is expected to be a growth center for the world economy into the next century, addressing bilateral political and economic problems would benefit the region as well as both Japan and South Korea. The frank discussions involved in drafting the action program may contribute to increased recognition of the other party's concerns. That may prove to be an essential first step in airing the differences in perception that pose fundamental barriers to improved overall Japan-South Korea relations.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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JAPANESE RESEARCH AND DEVELOPMENT: AN ERA OF "TECHNOGLOBALISM"

SUMMARY

By most statistical measures Japanese research and development remains extremely healthy and vigorous. Spending growth is strong and widespread through Japanese industry and government. When evaluated by new self-proclaimed measures of international cooperation and participation, however, Japan's R&D policies come up short. The debate among Japanese science policymakers and business leaders over the direction of the nation's research policies involves important consequences for the international community as well as domestic companies. Whether "technoglobalism," the emphasis on the international pursuit and sharing of technology and research, is the right answer to the new demands being placed on Japan is a key part of this debate.

Introduction

Japan's private and government research and development planners are finding that pledging a level of global science and technology contributions that reflect the nation's economic strength is easier than actually accomplishing this. Policies aimed at developing new know-how already are in place; now Tokyo is drawing up and implementing plans to share technology with not only developed but developing countries. Steps that go beyond the existing policy of opening Japan's R&D programs to foreign participation include eliciting foreign input at the planning stage of government projects. Japanese policymakers anticipate that the continued expansion of Japan's global R&D contributions will require a boost in overall spending and a need to address new priorities and roles.

Similar tasks face Japan's private sector, the driving force behind the nation's leap to the leading edge of industrial technology. In an era of deregulation government officials find they have fewer levers to encourage companies to be more generous and open-minded with regard to technology transfer to potential foreign competitors. Nevertheless, economic, business and technological forces are driving Japanese firms to reconsider their technology policies, perhaps signaling a new age of "technoglobalism." This term, coined in Japanese circles, indicates the borderless pursuit of scientific and technical research with the participation of governments as well as companies worldwide.

Spending Fest Continues

The latest government review of total R&D spending in Japan showed a 10.7 percent increase to ¥13.1 trillion ($97 billion at ¥135=$1.00) in the year ending March 31, 1991 (see Table 1a). FY 1990's gain represented the second consecutive double-digit performance, marking an end to the FY 1986-FY 1988 slowdown in the growth of R&D spending. Yet, since Japanese R&D spending clearly is influenced by the pace of overall economic activity, it will be interesting to compare the impact of the current recession on R&D spending with the record of the FY 1986-FY 1988 period. Reports to date point to somewhat lower rates of growth, at least by industry.

Spending by Organization - The corporate sector stretched its lead in FY 1990 with a 12.6 percent gain to nearly ¥9.3 trillion ($68.6 billion). The FY 1990 showings by universities and research institutions were better than the previous year (but only by a fraction in the latter case). The acceleration of R&D spending by universities to a recent high is encouraging news for basic research in Japan, since much fundamental science work takes place in the academic community. Whether the relatively low level of growth in research institutions' spending (compared to the boom years of FY 1985 and FY 1987) signals a structural shift in expenditure patterns or simply is within normal variations requires more years of data. Funding for research institutes depends on the whims of corporate and government budget planners; that complicates an analysis of how or if their role is changing.

Funding Sources - The private sector maintained an easy lead in FY 1990 as the primary source of R&D funding (Table 1b); in fact, its share of total financing increased again. The 11.6 percent expansion in corporate outlays was healthy but, since growth was less than the 13 percent jump the year before, may indicate a reappraisal of priorities. Public R&D funds grew 6.5 percent in FY 1990, the second consecutive solid improvement over the previous fiscal year and an above-average gain compared with the late 1980s. Still, this growth did not return the government's share of total R&D funding to the 20 percent-plus level of the years prior to FY 1988; in fact, the 17.9 percent figure represented a new low share for the second consecutive year. The government's R&D budget clearly has not been safe from the Ministry of Finance's fiscal austerity axe, but the planned gain in government R&D spending for the current fiscal year is an encouraging sign that Tokyo takes seriously its new commitment to make Japan a global technology source.

Funding by Purpose - For the third year in a row data on Japanese R&D by purpose cast doubt on at least corporate Japan's willingness to become a source of basic research knowledge. While the share of money for developmental work, which leads directly to commercial products, held steady in FY 1990, the proportion allotted to basic research edged back (see Table 2). That basic research lost while applied research gained a similar percentage share is small consolation to observers concerned that Japan is pulling back from basic research in favor of commercialization as global economic competition heats up.

Data broken down by purpose by spending organization reveals a surprising story behind the above trend (see Table 3). One might expect that the dominant role of private R&D spending in Japan would lie at the root of the waning financial attention given basic research. Despite the supposed long-term outlook and patience of Japanese management, R&D spending still must be justified by bottom-line results. Accordingly, private R&D spending tends toward commercial applications. Thus, it would not be surprising if overall spending moved in this direction, since the private sector accounts for the majority of Japanese R&D spending and shows the highest growth rate. The breakdown of

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Table 1: Japan's R&D Expenditures, FY 1985-FY 1990

(in billions of yen and percent)

a. By Spending Organization

Fiscal Year	Companies	Research Institutions	Universities	Total
1985	¥5,939.9	¥1,160.6	¥1,789.8	¥8,890.3
Change	15.6%	12.3%	3.8%	12.6%
Share	66.8%	13.1%	20.1%	100.0%
1986	6,120.2	1,240.2	1,832.6	9,192.9
Change	3.0%	6.9%	2.4%	3.4%
Share	66.6%	13.5%	19.9%	100.0%
1987	6,494.3	1,384.5	1,957.9	9,836.6
Change	6.1%	11.6%	6.8%	7.0%
Share	66.0%	14.1%	19.9%	100.0%
1988	7,219.3	1,394.2	2,014.1	10,627.6
Change	11.2%	0.7%	2.9%	8.0%
Share	67.9%	13.1%	19.0%	100.0%
1989	8,233.8	1,452.3	2,129.4	11,815.5
Change	14.1%	4.2%	5.7%	11.2%
Share	69.7%	12.3%	18.0%	100.0%
1990	9,267.2	1,514.2	2,297.0	13,078.3
Change	12.6%	4.3%	7.9%	10.7%
Share	70.9%	11.6%	17.6%	100.0%

b. By Source of Funds

Fiscal Year	Government	Private	Foreign	Total
1985	¥1,867.3	¥7,014.9	¥8.1	¥8,890.3
Change	5.0%	14.8%	6.6%	12.6%
Share	21.0%	78.9%	0.1%	100.0%
1986	1,955.3	7,229.7	7.9	9,192.9
Change	4.7%	3.1%	-2.5%	3.4%
Share	21.5%	78.4%	0.1%	100.0%
1987	2,111.8	7,716.6	8.2	9,836.6
Change	8.0%	6.7%	3.8%	7.0%
Share	21.5%	78.4%	0.1%	100.0%
1988	2,117.8	8,501.5	8.3	10,627.6
Change	0.3%	10.2%	1.2%	8.0%
Share	19.9%	80.0%	0.1%	100.0%
1989	2,202.4	9,603.3	9.7	11,815.5
Change	4.0%	13.0%	16.7%	11.2%
Share	18.6%	81.3%	0.1%	100.0%
1990	2,346.6	10,721.5	10.3	13,078.3
Change	6.5%	11.6%	6.2%	10.7%
Share	17.9%	82.0%	0.1%	100.0%

Source: Management and Coordination Agency, *Report on the Survey of Research and Development*.

Table 2: **Japan's Research Expenditures by Purpose, FY 1985-FY 1990**

(in billions of yen and percentage share)

Fiscal Year	Basic Research	Applied Research	Developmental Research
1985	¥1,030.6 12.9%	¥2,001.8 25.0%	¥4,985.9 62.2%
1986	1,102.8 13.3%	2,030.8 24.4%	5,185.0 62.3%
1987	1,250.2 14.0%	2,166.8 24.3%	5,497.3 61.7%
1988	1,288.0 13.3%	2,346.6 24.3%	6,041.0 62.4%
1989	1,390.9 12.8%	2,588.4 23.9%	6,848.0 63.2%
1990	1,510.2 12.6%	2,906.1 24.2%	7,577.2 63.2%

Source: Management and Coordination Agency, *Report on the Survey of Research and Development.*

Table 3: **Japan's Research Expenditures by Spending Organization by Purpose, FY 1985-FY 1990**

(share of each organization's total expenditures in percent)

Fiscal Year	Basic Research	Applied Research	Developmental Research
1985			
Universities	54.2%	37.4%	8.4%
Research Institutions	12.3	30.0	57.7
Companies	5.9	21.9	72.1
1986			
Universities	54.2	37.4	8.4
Research Institutions	13.8	27.4	58.8
Companies	6.1	21.6	72.3
1987			
Universities	54.2	37.4	8.4
Research Institutions	15.8	26.0	58.2
Companies	6.6	21.7	71.7
1988			
Universities	52.8	38.5	8.7
Research Institutions	14.9	25.4	59.7
Companies	6.6	21.7	71.7
1989			
Universities	53.2	38.1	8.7
Research Institutions	15.3	25.7	59.0
Companies	6.4	21.5	72.2
1990			
Universities	52.9	38.4	8.7
Research Institutions	15.7	26.6	57.7
Companies	6.4	21.8	71.8

Source: Management and Coordination Agency, *Report on the Survey of Research and Development.*

corporate work among basic, precommercial (applied) and commercial research, however, shows that companies allocated the *same* share of funds to basic R&D in FY 1990 as the year before. Research institutions put more of their money into basic work. Universities, however, cut their share by several tenths of a percentage point. Interestingly, these funds were shifted to applied research rather than developmental research, an area one might expect universities to place ahead of commercial applications.

Government Spending

Japanese budget planners continue to present as conventional wisdom the theme of fiscal austerity, the Ministry of Finance's chief weapon since the early 1980s against the burgeoning national debt (see *JEI Report* No. 16A, May 24, 1992). While MOF was able to keep a lid on new spending through the mid-1980s, its grip has loosened as greater domestic and international expectations have been placed on Japan. Supporting research clearly is important to Tokyo, but this category does not enjoy carte blanche. Table 4 shows that the growth of research outlays merely has kept pace with the expansion of total spending (its share has varied only marginally). Government-funded R&D has expanded faster, however, than discretionary spending.

Table 4: **Research Expenditures as Share of General Account Budget, FY 1985-FY 1992**

(revised budgets in billions of yen and percent)

a. As Share of Total Expenditures

Fiscal Year	Total Expenditures	Research Expenditures	Share
1985	¥53,222.9	¥1,521.6	2.9%
1986	53,824.8	1,599.0	3.0
1987	58,241.2	1,655.0	2.8
1988	61,851.7	1,715.7	2.8
1989	66,311.9	1,814.8	2.7
1990	69,651.2	1,920.9	2.8
1991	70,347.4	2,022.6	2.9
1992*	72,218.0	2,134.7	3.0

b. As Share of Discretionary Expenditures

Fiscal Year	Total Expenditures	Research Expenditures	Share
1985	¥33,352.3	¥1,521.6	4.6%
1986	33,425.7	1,599.0	4.8
1987	35,276.5	1,655.0	4.7
1988	36,789.8	1,715.7	4.6
1989	39,257.4	1,814.8	4.6
1990	39,271.0	1,920.9	5.0
1991	39,276.7	2,022.6	5.1
1992*	39,998.8	2,134.7	5.3

*Initial budget.

Source: Ministry of Finance

FY 1992 data on government R&D spending by agency appears to present a mixed bag of gains, with at least one hefty loss (see Tables 5 and 6). Overall R&D spending growth for the current fiscal year initially is budgeted 5.5 percent higher, greater than FY 1991's final gain of 5 percent. For the second consecutive year the direction of spending in FY 1992 is evenly upward (compared with FY 1991's initial increases), with a notable exception. The significant cut at the Ministry of Labor, one of the three organizations receiving less money in the current fiscal year, means it initially at least has lost in FY 1992 all that it gained in FY 1991 and then some; its total R&D budget rose from just under ¥4.2 billion ($31.1 million) in FY 1990 to ¥5 billion-plus ($37 million) before plunging to ¥3.8 billion ($28.1 million). The Ministry of Education's 1.5 percentage-point improvement over FY 1991 may signal its successful campaign with MOF for funds to upgrade research facilities at the nation's universities and to bolster basic research, a goal that requires a sustained effort. Perhaps signaling a growing response to international responsibilities, the Ministry of Foreign Affairs' R&D budget is up 15 percent, although much of this money goes for administrative bodies, such as the International Atomic Energy Agency and other research-related multilateral organizations.

For most agencies, though, FY 1992 cannot be seen as an extraordinarily prosperous year. Among those seeing growth rates shrink were the Ministry of Transportation and the Environment Agency. (See *JEI Report* No. 36A, September 27, 1991 for full details on the previous year's figures.) Thanks to a growth rate of 10.4 percent in FY 1992 the Japan Defense Agency appears to be on its way toward its policy goal of doubling R&D's share of its budget from 2.5 percent to 5 percent by FY 1995, but the end of the Cold War and new prospects for warmer relations between Japan and the former Soviet Union still could dampen the pace of defense-related R&D in future years.

A clearer picture of each agency's priorities can be seen from FY 1991-FY 1992 spending plans (see Table 7). Basic research has its ups and downs in FY 1992, sometimes within the same ministry. For example, while the Education Ministry's overall FY 1992 R&D budget shows a 6 percent gain, funds for university research are up 6.1 percent, but grants for national university researchers will expand only 2.4 percent. Nonetheless, one of the major themes in Japan's basic research program — internationalism, either inviting foreign researchers to come to Japan or forming joint projects to carry out research around the globe — appears to be gaining strength. Programs with an international flavor and increased funding levels include: the Human Frontiers Science Program funded by the Science and Technology Agency and the Ministry of International Trade and Industry, plus MITI's nuclear energy and energy conservation programs.

Government-sponsored environmental research programs present a mixed picture in FY 1992, contrasting sharply with their uniform growth in FY 1991 and perhaps raising questions about Tokyo's sincerity on its environmental commitments. STA, for example, is sharply hiking funds for its Green Planet Project but is cutting outlays for other environmental programs. Moreover, many of the Environment Agency's research projects linked to international issues have gained greater funding this fiscal year, but strictly domestic programs have not fared as well. Although the Environment Agency clearly is devoting more money to environmental programs, its activities fund only a small piece of Japan's environmental R&D. Other agencies, though, are in the early stages of assembling environmental programs, as shown by the R&D budgets for the Ministry of Posts and Telecommunications and the Ministry of Construction.

Overall, public R&D spending continues to focus funds on developing precommercial know-how, an approach that many observers credit for Japan's economic growth. Areas in which corporate Japan is unlikely to risk bearing the full costs on its own, such as space development, are receiving greater emphasis from the government. Its FY 1992 budget also clearly signals increased support for basic and international research ("international" in that it either involves foreign participation or is aimed at global issues). Tokyo appears to be building an institutional framework to channel the flow of government R&D spending into new areas. The success or failure of these efforts, however, is not dependent on funding alone. Support from the private sector and foreign countries will be important factors.

Table 5: **Japanese Government R&D Expenditures, Revised FY 1991**

(in millions of yen and percentage change)

	Science Promotion	Energy and Other Research	Special Research*	Total
Diet	¥519	¥0	¥0	¥519
	-0.8%	--	--	-0.8%
Japan Technology Council	0	1,051	0	1,051
	--	10.5%	--	10.5%
Police Agency	1,133	0	0	1,133
	3.4%	--	--	3.4%
Hokkaido Development Agency	141	0	0	141
	-2.1%	--	--	-2.1%
Defense Agency	0	115,045	0	115,045
	--	10.3%	--	10.3%
Economic Planning Agency	850	0	0	850
	5.1%	--	--	5.1%
Science and Technology Agency	220,600	165,575	133,045	519,220
	8.3%	0.4%	6.5%	5.2%
Environment Agency	10,527	0	0	10,527
	15.2%	--	--	15.2%
Justice Ministry	989	0	0	989
	4.1%	--	--	4.1%
Foreign Ministry	0	8,160	0	8,160
	--	15.0%	--	15.0%
Finance Ministry	388	0	811	1,199
	4.0%	--	11.2%	8.8%
Education Ministry	73,566	131,030	728,718	933,314
	1.1%	0.9%	5.7%	4.6%
Health Ministry	41,894	2,159	11,707	55,760
	7.9%	63.7%	5.5%	8.8%
Agriculture Ministry	66,832	2,807	3,300	72,939
	2.3%	6.2%	0.0%	2.5%
International Trade	55,934	13,843	185,605	255,382
and Industry Ministry	-0.1%	4.4%	1.6%	2.1%
Transportation Ministry	13,498	5,926	1,145	20,569
	23.8%	79.0%	11.0%	17.3%
Posts and Telecommunications	5,086	232	28,600	33,918
Ministry	11.5%	22.6%	10.0%	8.4%
Labor Ministry	666	6	4,367	5,039
	5.2%	-83.6%	24.0%	20.2%
Construction Ministry	5,887	732	0	6,619
	3.9%	61.2%	--	8.9%
Home Affairs Ministry	604	0	0	604
	3.8%	--	--	3.8%
Total	499,116	446,565	1,068,698	2,014,379
	5.3%	4.2%	5.1%	5.0%

*Column adds to more than the total because of double-counting of budgets for projects shared by more than one agency.

Source: Japan Society for the Promotion of Science, *Japanese Scientific Monthly*, July 1992.

Table 6: Japanese Government R&D Expenditures, Initial FY 1992

(in millions of yen and percentage change)

	Science Promotion	Energy and Other Research	Special Research*	Total
Diet	¥536	¥0	¥0	¥536
	0.6%	--	--	0.6%
Japan Technology Council	0	1,042	0	1,042
	--	-0.8%	--	-0.8%
Police Agency	1,209	0	0	1,209
	5.7%	--	--	5.7%
Hokkaido Development Agency	150	0	0	150
	1.4%	--	--	1.4%
Defense Agency	0	126,989	0	126,989
	--	10.4%	--	10.4%
Economic Planning Agency	930	0	0	930
	9.4%	--	--	9.4%
Science and Technology Agency	246,208	165,657	139,912	551,778
	9.9%	0.0%	5.2%	5.6%
Environment Agency	11,847	0	0	11,847
	8.7%	--	--	8.7%
Justice Ministry	1,063	0	0	1,063
	5.7%	--	--	5.7%
Foreign Ministry	0	8,251	0	8,251
	--	1.1%	--	1.1%
Finance Ministry	407	0	1,028	1,434
	6.6%	--	26.7%	20.3%
Education Ministry	84,899	134,189	773,020	992,108
	10.9%	2.4%	6.1%	6.0%
Health Ministry	47,234	1,864	12,240	61,338
	11.7%	-13.7%	4.6%	9.3%
Agriculture Ministry	69,935	2,942	3,300	76,177
	3.7%	4.8%	0.0%	3.6%
International Trade	56,205	14,066	188,951	259,223
and Industry Ministry	-0.5%	1.6%	1.8%	1.3%
Transportation Ministry	14,436	6,944	1,135	22,515
	7.4%	17.2%	-0.9%	9.8%
Posts and Telecommunications	5,289	444	27,000	32,733
Ministry	4.3%	91.4%	-5.6%	-3.5%
Labor Ministry	699	6	3,082	3,787
	3.9%	1.0%	-29.4%	-24.9%
Construction Ministry	6,150	786	0	6,936
	4.4%	7.3%	--	4.7%
Home Affairs Ministry	631	0	0	631
	2.4%	--	--	2.4%
Total	547,289	463,180	1,123,667	2,134,676
	8.0%	3.7%	5.1%	5.5%

*Column adds to more than the total because of double-counting of budgets for projects shared by more than one agency.

Source: Japan Society for the Promotion of Science, *Japanese Scientific Monthly*, July 1992.

Table 7: Expenditures on Selected Science Programs by Agency, FY 1991-FY 1992

(in millions of yen)

	FY 1991	FY 1992
Japan Defense Agency		
Technology development	¥115,045	¥125,880
Science and Technology Agency		
Promotion of innovative and basic technology	10,127	11,201
Green Planet Project (global warming)	10,306	18,855
Human Frontiers Science Program	2,194	2,284
Science and technology promotion	14,397	16,012
Science policy administration	11,189	11,721
Nuclear energy research	306,435	315,230
Outerspace research	131,769	144,642
Ocean technology development	10,666	11,400
Environmental, planetary research	35,662	31,648
Materials research	13,548	14,099
Life sciences research	18,976	21,350
Environment Agency		
National Environment Research Institute	5,977	6,359
Global environmental research	1,700	1,900
National Disaster Prevention Institute	1,928	1,918
Foreign Ministry		
International agricultural research group	3,385	3,475
OECD Nuclear Power Committee	324	328
Education Ministry		
Environmental research	33,472	39,517
Japan Technology Promotion Council grants	6,661	7,657
University research programs	728,718	773,020
National university research grants	131,029	134,189
Health Ministry		
Agency research	16,926	19,367
Research grants	20,391	22,062
Pharmaceutical research	2,300	2,300
Health science research	7,426	8,520
Cancer research projects	3,352	3,694
International cancer research	176	165
Medical and drug information system	149	149
Agriculture Ministry		
Agency research	57,330	59,272
Basic research	3,766	3,924
International cooperation	467	509
Private industry support	814	890
Regional development programs	2,485	2,524
Environmental research	146	147
Tropical agriculture research	716	776
Food product technology	642	625
International Trade and Industry Ministry		
Large-scale industrial technology projects	10,998	12,057
Basic computer technology development	5,041	5,809
Basic Technology Promotion Center	28,600	26,000
Next-generation basic technology projects	7,869	8,157
New energy technology development projects	24,817	25,779
Energy conservation projects	11,487	11,517
Nuclear energy development projects	28,724	27,971
Human Frontiers Science Program	1,515	1,552
International aircraft development	3,670	4,310
Global Environment Industrial Technology Institute	6,748	7,930
Small business technology improvement	6,495	6,135
Transportation Ministry		
Agency research (including five ship technology centers)	8,554	9,077
Weather satellite programs	2,946	3,414
Magnetic levitation train technology	4,705	5,704
Next-generation ship technology	936	955
Posts and Telecommunications Ministry		
Electrotechnical laboratories	5,072	5,289
Communications Frontier Research	470	577
Space communications	942	956
Environmental projects	119	145
Basic Technology Promotion Center	28,600	26,000
Labor Ministry		
Agency research	3,152	3,082
Industrial safety research	2,043	603
Japan Bioassay Research Center	1,363	1,378
Construction Ministry		
Agency research (including one engineering center)	5,055	5,194
Construction technology research	765	793
Environmental projects	49	n.a.

Source: Japan Society for the Promotion of Science, *Japanese Scientific Monthly*, July 1992.

Private Spending

The data in Tables 1 and 2 confirm the dominant role of private R&D in Japan. Companies outspent the government by more than 4-to-1 in FY 1990, as intense competition — both domestic and foreign — stimulated Japanese industry to adopt a strong technology development program. Historical data indicate that corporate R&D spending is not immune completely when company bean counters trim budgets, but R&D items have been spared from heavy cutbacks during earlier economic downturns because such spending is considered crucial to a firm's future. Nevertheless, many firms are taking a hard look at their research budgets as part of a general reassessment of their business strategies. A new emphasis on coexistence and "symbiosis" (to use the current Japanese buzzword) with foreign competitors as well as a reconsideration of the balance between profits and market share have blunted the edge of the private sector's all-out assault on advanced research. This reappraisal of investment strategies has been particularly noticeable with the fall of the Tokyo stock market and the higher cost of raising new funds.

Although the latest government data on private R&D predate the current slump, they reveal that halving of year-to-year growth rates in some industry sectors is as common as doubling funding from one year to the next in others (see Table 8). The reasons for these swings are not apparent from the survey data, and there is no obvious pattern in the gains and cutbacks that might arise from macroeconomic factors. This patchy performance calls into question the common view that Japanese companies exhibit a long-term, steady commitment to R&D. While this may be true for certain firms, it clearly is less compelling at the industry level. Nevertheless, companies in industries where Japanese competitors are recognized as world leaders reflect a solid commitment to R&D spending. Examples include parts of the textile, chemicals, nonelectric machinery, electronics and transportation equipment industries. Faced with challenges at the upper end of their markets by firms from advanced industrialized countries and at the lower end by companies based in rapidly developing Asian nations, Japanese corporations understand that they will be passed if they stand still.

Not surprisingly, the mixed picture of increases and reductions carries over when corporate R&D spending is expressed as a share of gross sales (see Table 9). While all industries recorded a higher R&D-to-gross sales ratio in FY 1990 than a decade previously, a comparison of FY 1989 and FY 1990 data shows that the movement is not inexorably upward. Again, the government survey does not reveal the reasons for the declines; nor is any pattern apparent.

Since the private sector is the hotbed of R&D activity in Japan, companies not surprisingly are under increasing international pressure to share their technology. Corporate Japan is faced with two demands: increase funding for basic research (which traditionally has been considered a public commodity) and transfer more technology to foreign partners. As mentioned above, the business sector put more money in FY 1990 into applied research at the expense of developmental purposes while keeping funding for basic work steady. Table 10 shows that while the overall figures may have moved in one direction, not all industries followed that move. Some major industries reported gains of about 2 percentage points or more in funding for basic research, such as food products, plastics and steel. Among those showing reductions were chemicals, including pharmaceuticals, plus electric machinery and transportation equipment. As for developmental research, 16 of the 26 separately classified industries cut this category of spending, eight increased outlays and two kept them unchanged. Industries increasing spending for applied research outnumbered those cutting funding by a margin of 18 to seven, with one remaining the same.

Technology Trade

The international community continues to have the highest expectations of Japanese science in the area of technology trade. When country-to-country talks produce requests for greater technology transfers, Tokyo points out that the private sector needs to be a factor in such discussions. With the private sector exercising the leading role in Japanese R&D, much of the most desirable technology for transfer abroad continues to be in private, not government, hands. Companies understandably are loathe to disclose to competitors any discoveries or potentially important know-how, and they are even less inclined to do so without adequate compensation. While advanced nations may feel Japan is indebted to them for relatively unlimited access to their technology, Japanese manufacturers argue that their technological achievements are due as much to their own efforts as to foreign help. In addition, these companies maintain that their technology-gathering was aboveboard and paid for through licensing fees and royalties. Nevertheless, at the government level officials have committed Japan to becoming a net contributor of technology, particularly to developing nations.

Table 8: **Japan's R&D Expenditures by Industry, FY 1989-FY 1990**

(in billions of yen and percentage change)

	FY 1989		FY 1990	
	Total	Change	Total	Change
Agriculture	¥4.4	-46.3%	¥10.9	146.2%
Mining	24.6	-12.5	29.7	20.9
Construction	185.1	24.7	212.7	14.9
Manufacturing	7,706.2	14.1	8,660.3	12.4
Food Products	203.6	13.5	217.5	6.8
Textiles	81.3	11.6	88.3	8.6
Pulp and Paper	45.5	6.3	48.6	6.8
Publishing and Printing	33.7	33.0	37.7	11.7
Chemicals	1,313.9	10.4	1,416.8	7.8
Industrial Chemicals and Synthetic Fibers	552.0	10.1	587.4	6.4
Oils and Paints	134.5	15.6	139.1	3.4
Pharmaceuticals	456.0	9.5	516.1	13.2
Other	171.4	9.7	174.2	1.6
Petroleum and Coal Products	84.2	12.3	92.0	9.2
Plastic Products	120.8	32.8	111.7	-7.5
Rubber Products	111.8	10.1	117.9	5.5
Nonmetallic Mineral Products	221.4	11.5	215.3	-2.8
Steel	268.1	7.4	303.8	13.3
Nonferrous Metals	127.0	5.6	140.7	10.7
Fabricated Metal Products	109.3	22.0	129.6	18.6
Nonelectric Machinery	559.0	23.9	650.3	16.3
Electric Machinery	2,808.1	14.5	3,146.3	12.0
Communications and Electronics Equipment	1,941.7	13.6	2,150.0	10.7
Other	866.4	16.8	996.2	15.0
Transportation Equipment	1,244.6	14.6	1,496.1	20.2
Motor Vehicles	1,087.2	16.6	1,295.6	19.2
Other	157.4	2.2	200.5	27.4
Precision Machinery	266.1	11.5	335.8	26.2
Other	107.8	18.7	112.1	4.1
Transportation, Communications and Utilities	313.5	12.0	353.6	12.8
Total	8,233.8	14.1	9,267.2	12.6

Source: Management and Coordination Agency, *Report on the Survey of Research and Development*.

The latest government data on technology flows indicate that Japan has lost some ground in its drive to achieve this goal. Total exports and imports alone tell less than a look at new technology transactions and their value (see Tables 11 and 12). Japan long has exported more new technology (which excludes payments or renewals of previous deals) than it imports, but the value of this technology has been erratic. When viewed from Japan's attempts to encourage technology transfers, however, the transactions in both new and overall exports dropped between FY 1989 and FY 1990, as did the value of new exports (but not the overall value).

Table 9: **Japan's Ratio of Corporate R&D Expenditures to Gross Sales by Industry, FY 1980-FY 1990**

(in percent)

Industry	FY 1980	FY 1985	FY 1989	FY 1990
Agriculture	0.17%	0.24%	0.21%	0.50%
Mining	0.52	1.03	0.94	1.13
Construction	0.46	0.49	0.52	0.54
Manufacturing	1.73	2.69	3.29	3.36
Food Products	0.58	0.77	1.07	0.98
Textiles	0.77	1.18	1.71	1.76
Pulp and Paper	0.41	0.71	0.79	0.88
Publishing and Printing	0.26	0.68	0.71	0.88
Chemicals	2.55	3.79	4.84	4.89
Industrial Chemicals and Synthetic Fibers	1.85	2.80	4.09	4.01
Oils and Paints	2.48	3.14	3.93	3.90
Pharmaceuticals	5.45	7.04	7.50	8.02
Other	2.19	3.61	4.11	4.06
Petroleum and Coal Products	0.30	0.38	0.72	0.64
Plastic Products	n.a.	1.75	2.73	2.37
Rubber Products	2.10	2.86	3.25	3.20
Nonmetallic Mineral Products	1.30	2.61	2.75	2.60
Steel	1.14	1.94	2.21	2.33
Nonferrous Metals	1.03	1.92	1.91	1.80
Fabricated Metal Products	1.15	1.59	1.36	1.60
Nonelectric Machinery	1.90	2.74	2.83	2.99
Electric Machinery	3.71	5.10	5.89	5.86
Communications and Electronics Equipment	3.94	5.25	6.10	6.12
Other	3.35	4.82	5.47	5.36
Transportation Equipment	2.34	2.90	3.40	3.65
Motor Vehicles	2.38	2.96	3.48	3.73
Other	2.15	2.61	2.93	3.20
Precision Machinery	3.02	4.49	5.16	5.94
Other	1.16*	0.97	1.19	1.21
Transportation, Communications and Utilities	0.32	0.98	1.06	1.07
All Industry Average	1.48	2.31	2.72	2.78

*Includes plastic products.

Source: Management and Coordination Agency, *Report on the Survey of Research and Development*.

FY 1990 was a banner year for renewing previous technology import agreements; the total number of import transactions (renewals plus new) rose sharply, while the number of new import contracts fell. Although this import surge produced the expected boost in the total value of import contracts, the sharp increase in the cost of new import agreements indicates that each contract, or perhaps several key contracts, carried a significantly robust royalty. The opposite situation appeared to exist on the export side. The total number of contracts fell but their value rose, while the total number of new agreements and their value both dropped. American companies have been defending

Table 10: **Japan's Corporate R&D Expenditures by Purpose, FY 1989-FY 1990**

(in percent of total sectoral spending)

	Basic Research		Applied Research		Developmental Research	
Industry	1989	1990	1989	1990	1989	1990
Agriculture	8.8%	14.4%	30.9%	34.8%	60.3%	50.8%
Mining	17.0	16.9	28.1	31.9	54.9	51.2
Construction	6.1	6.5	22.8	24.1	71.1	69.4
Manufacturing	6.4	6.3	21.0	21.2	72.6	72.5
Food Products	12.1	14.0	32.3	30.4	55.6	55.6
Textiles	6.1	7.2	26.9	27.0	67.0	65.7
Pulp and Paper	4.2	5.8	26.0	36.2	69.8	58.0
Publishing and Printing	5.9	3.6	45.3	50.7	48.8	45.7
Chemicals	13.7	12.8	27.8	28.5	58.5	58.8
Industrial Chemicals and Synthetic Fibers	10.7	9.1	30.0	32.0	59.4	58.9
Oils and Paints	4.4	5.2	33.3	31.2	62.2	63.5
Pharmaceuticals	20.9	19.6	26.8	27.4	52.3	53.0
Other	11.4	10.9	19.1	17.3	69.5	71.8
Petroleum and Coal Products	11.1	12.2	24.3	27.2	64.6	60.6
Plastic Products	3.0	5.0	25.4	25.0	71.6	70.1
Rubber Products	4.1	4.4	19.8	20.5	76.2	75.1
Nonmetallic Mineral Products	8.3	7.4	22.4	23.3	69.3	69.3
Steel	10.8	12.9	25.0	19.8	64.2	67.2
Nonferrous Metals	4.3	3.9	29.2	28.0	66.5	68.1
Fabricated Metal Products	2.3	4.7	16.1	22.0	81.6	73.3
Nonelectric Machinery	3.9	4.7	21.0	22.2	75.0	73.1
Electric Machinery	4.1	4.3	18.7	19.2	77.2	76.5
Communications and Electronics Equipment	3.9	4.2	18.5	19.3	77.6	76.5
Other	4.7	4.5	19.0	19.0	76.3	76.5
Transportation Equipment	4.1	3.8	13.4	13.1	82.5	83.1
Motor Vehicles	3.9	3.5	11.8	11.3	84.2	85.2
Other	5.3	5.6	24.3	24.7	70.4	69.7
Precision Machinery	4.3	3.4	22.2	24.3	73.5	72.3
Other	4.2	3.4	22.1	22.5	73.7	74.1
Transportation, Communications and Utilities	5.5	5.9	32.1	34.9	62.4	59.3
All Industry Average	6.4	6.4	21.5	21.8	72.2	71.8

Source: Management and Coordination Agency, *Report on the Survey of Research and Development.*

their intellectual property rights more aggressively with respect to foreign competitors, and many lucrative relicensing agreements have been publicized over the past year. It is not clear, however, if this business strategy is the cause of the divergence between the value of old and new technology agreements.

The divergence between import cases and values has several anomalies (see Table 13). While the electronics sector's technology balance slipped further into deficit in both number of transactions and value, the average values of imports dropped in FY 1990, as did that of exports. In the publishing and printing industry, which accounted for most of the increased technology inflow, the number of import agreements soared, although the value of the deals rose only marginally. In general, the manufacturing sector, which naturally accounts for the bulk of technology trade, was a net importer in both numerical and value terms in FY 1990 and accounted for most of the gain in overall imports.

On the export side only slightly more industries exported technology in FY 1989 than FY 1990 (14 versus 12 specific categories), but the values of exports generally rose in more cases. Notably, the steel industry slackened its technology exports in FY 1990, as did the textile, fabricated metal products and precision machinery industries. Export boosters included the motor vehicle and the chemicals industries.

Table 11: **Japan's Technology Exports, FY 1975-FY 1990**

(number of approved cases and value in billions of yen)

	Cases		Value	
	Total	Of Which New:	Total	Of Which New:
FY 1975	2,811	1,073	¥66.6	¥18.9
FY 1980	4,103	1,237	159.6	74.3
FY 1985	5,885	2,099	234.2	73.3
FY 1986	5,469	1,730	224.1	51.8
FY 1987	5,955	1,655	215.6	44.8
FY 1988	6,352	1,850	246.3	47.4
FY 1989	7,559	2,086	329.3	66.6
FY 1990	7,163	1,570	339.4	58.6

Source: Management and Coordination Agency, *Report on the Survey of Research and Development.*

Table 12: **Japan's Technology Imports, FY 1975-FY 1990**

(number of approved cases and value in billions of yen)

	Cases		Value	
	Total	Of Which New:	Total	Of Which New:
FY 1975	6,766	796	¥169.1	¥13.3
FY 1980	7,248	919	239.5	27.7
FY 1985	7,679	1,245	293.2	33.3
FY 1986	7,494	1,141	260.6	33.6
FY 1987	7,373	813	283.2	56.2
FY 1988	8,356	1,382	312.2	54.6
FY 1989	7,109	1,056	329.9	48.4
FY 1990	8,249	956	371.9	73.4

Source: Management and Coordination Agency, *Report on the Survey of Research and Development.*

The pattern of technology trade by country (see Table 14) followed traditional lines in FY 1990, with a few notable points. Exports of Japanese technology to Asian nations continued to represent the bulk of activity on this side of the ledger. Although exports to China and South Korea dropped, those to Taiwan, Thailand and Indonesia continued to show solid gains. Exports to the United States and Western Europe were off or flat but, together, still accounted for about 31 percent of Japanese technology export transactions and 43 percent of their value.

Table 13: **Japan's Corporate Technology Trade by Industry, FY 1989-FY 1990**

(number of cases and value in billions of yen)

	FY 1989				FY 1990			
	Exports		Imports		Exports		Imports	
	Cases	Value	Cases	Value	Cases	Value	Cases	Value
Agriculture	5	¥0.0	1	¥0.0	4	¥0.0	10	¥0.0
Mining	9	0.0	27	0.3	15	0.8	9	0.7
Construction	219	12.4	290	2.0	286	16.9	166	1.8
Manufacturing	7,286	316.2	6,776	326.9	6,821	320.7	8,035	368.3
Food Products	142	8.3	93	8.5	165	8.0	94	8.6
Textiles	358	4.6	95	4.8	105	3.9	75	4.7
Pulp and Paper	36	0.6	21	1.3	37	1.0	21	0.5
Publishing	33	0.4	91	1.6	34	0.5	1,287	2.6
Chemicals	1,297	53.6	942	56.9	1,359	58.2	1,096	54.0
Synthetic Fibers	610	29.5	473	23.2	611	27.7	482	21.0
Fertilizers	253	3.8	136	5.0	267	3.8	317	3.6
Pharmaceuticals	317	18.9	252	21.5	385	25.0	247	22.5
Other	117	1.5	81	7.2	96	1.7	50	6.9
Petroleum and Coal Products	14	0.5	113	3.8	20	0.2	86	3.3
Plastic Products	94	1.2	89	1.3	89	1.1	87	2.2
Rubber Products	174	4.8	108	3.8	121	5.1	101	4.5
Nonmetallic Mineral Products	252	9.0	174	4.1	300	11.9	206	3.9
Steel	551	21.6	320	4.8	360	9.4	309	6.5
Nonferrous Metals	267	7.1	221	10.7	241	7.2	173	13.9
Fabricated Metal Products	409	2.0	154	2.3	223	2.4	150	2.4
Nonelectric Machinery	777	13.2	1,270	33.0	772	14.4	1,077	30.5
Electric Machinery	1,669	86.7	1,825	120.6	1,693	97.0	1,917	159.9
Electronics	980	58.5	1,376	92.0	1,018	67.7	1,500	122.4
Machine Tools	689	28.2	449	28.5	675	29.4	417	37.4
Transportation Equipment	777	87.1	819	54.9	971	92.0	826	52.3
Motor Vehicles	525	83.0	250	7.2	729	88.9	254	7.6
Other	252	4.1	569	47.7	242	3.1	572	44.8
Precision Machinery	320	12.6	290	8.3	224	4.3	367	11.4
Other	116	2.9	151	6.3	107	3.9	163	7.0
Transportation, Communications and Utilities	40	0.6	15	0.7	37	0.8	29	1.2
Total	7,559	329.3	7,109	329.9	7,163	339.4	8,249	371.9

Source: Management and Coordination Agency, *Report on the Survey of Research and Development.*

Table 14: Japan's Corporate Technology Trade by Country, FY 1987-FY 1990

(number of cases and value in billions of yen)

a. Exports

	FY 1987		FY 1988		FY 1989		FY 1990	
	Cases	Value	Cases	Value	Cases	Value	Cases	Value
Asia	3,152	¥86.4	3,264	¥101.4	3,965	¥128.9	3,887	¥153.3
China	405	9.4	339	8.4	473	8.1	307	6.8
Taiwan	590	12.3	660	13.2	609	16.3	722	15.7
South Korea	816	27.5	888	30.6	1,350	38.5	1,129	46.5
Thailand	294	7.3	331	9.9	364	17.6	406	24.6
Philippines	133	2.0	n.a.	n.a.	n.a.	n.a.	108	2.4
Indonesia	182	3.2	228	13.6	304	10.9	468	19.7
Malaysia	147	3.1	128	4.0	221	6.3	209	7.2
India	182	3.2	211	5.4	245	6.2	204	5.6
West Asia	52	1.6	59	2.3	72	2.4	61	2.0
North America	1,058	72.5	1,225	77.0	1,671	115.1	1,417	108.1
United States	912	65.9	1,080	71.1	1,445	107.7	1,250	99.5
South America	198	4.5	195	4.4	182	4.6	200	2.9
Brazil	107	2.5	114	2.5	n.a.	n.a.	n.a.	n.a.
Europe	1,184	40.3	1,281	49.3	1,342	65.1	1,275	61.5
Great Britain	190	10.6	221	13.9	251	20.0	236	20.1
West Germany	297	7.4	301	10.7	328	13.7	323	11.7
France	162	5.2	137	4.4	149	7.1	149	9.4
Netherlands	53	2.1	86	2.2	71	2.1	63	1.8
Switzerland	52	2.3	63	1.4	51	1.6	53	1.7
Africa	147	5.0	141	6.0	136	6.8	137	6.3
Oceania	164	5.3	187	5.9	191	6.5	186	5.2
Australia	116	4.2	134	5.2	143	5.7	147	4.6

b. Imports

	FY 1987		FY 1988		FY 1989		FY 1990	
	Cases	Value	Cases	Value	Cases	Value	Cases	Value
Asia	12	¥0.1	29	¥0.2	26	¥0.3	18	¥0.2
China	2	*	0	0.0	3	*	2	*
Taiwan	2	*	15	0.0	4	*	1	*
South Korea	4	*	4	*	7	0.1	6	0.0
West Asia	2	*	0	0.0	8	0.1	10	0.1
North America	4,747	179.3	5,591	198.1	4,118	210.7	4,427	257.9
United States	4,667	178.6	5,495	196.9	4,029	209.5	4,332	255.3
South America	3	*	1	*	1	*	0	0.0
Europe	2,568	103.4	2,706	113.6	2,903	118.2	3,757	112.8
Great Britain	512	10.3	451	9.3	487	10.8	889	9.9
West Germany	847	21.4	835	18.4	1,104	24.3	1,258	27.0
France	313	22.1	432	26.2	354	25.5	324	22.8
Netherlands	173	20.8	182	27.6	202	21.1	200	20.2
Switzerland	273	17.4	277	18.4	256	19.0	635	15.3
Africa	3	*	0	0.0	0	0.0	1	*
Oceania	38	0.3	29	0.3	53	0.7	36	1.0

*Less than ¥50 million.

Source: Management and Coordination Agency, *Report on the Survey of Research and Development*.

The United States remained the largest single source of technology in FY 1990, but the 4,332 cases was well below the record high of 5,495 set in FY 1988. Imports of know-how from Western Europe grew steadily in number from FY 1987 through FY 1989 and then leapt nearly 30 percent in FY 1990, although their value actually dropped between FY 1989 and FY 1990. West Germany, Great Britain and Switzerland supplied most of the increase. An expanded Japanese presence on the continent in preparation for the European Community's economic integration may be a major reason for the volume of Japanese activity.

Tokyo's pledges to bear greater international responsibilities notwithstanding, areas outside Asia and the developed world have continued to receive scant attention from Japanese companies in terms of technology transfer, according to FY 1990 data. Technology exports to West Asia, South America and Africa showed little progress either that year or in the FY 1987-1989 period. There are few signs that this situation will change. But, because the data reflect only corporate technology trade and ignore government efforts, the level of Japanese technology transfer to these areas likely is understated.

Progress Toward New Goals

The debate in Japan over the nation's new international responsibilities has pushed Tokyo to revise its goals for R&D; this overhaul already is bringing about changes in policies and spending. At present Tokyo has enumerated four areas of concentration: fostering basic research; focusing on environmental issues; transferring technology to developing countries; and internationalizing its R&D system. These four goals often intertwine, sometimes creating positive synergy but also generating problems. Japanese aid officials, for example, are interested in transferring to developing nations technology that not only will make economic sense but environmental sense as well. Moreover, several of Tokyo's proposals for joint international research (applied and basic) have generated controversy overseas as well as within the Japanese government.

- Environmental Considerations - The previous discussion of government R&D spending by agency has shown a number of projects with a "green" theme. New projects continue to crop up, many with dual purposes. MITI, for example, is exploring ways to reduce emissions of exhaust gases from internal combustion engines in a way that also increases fuel efficiency. These exhaust gases are so-called greenhouse gases, which the government has pledged to limit. Another dual-purpose project is exploring methods of refrigeration and cooling that do not rely on chlorofluorocarbons that are said to harm the earth's protective ozone layer. Nevertheless, it still is not clear exactly how much "new" money is being spent on environmental projects and how much simply covers "old" projects with a coating of green.

- Technology Transfer - Japan has developed many technologies, such as small-scale manufacturing and energy systems, well-suited to developing countries because they do not require sophisticated maintenance or inputs not available locally. One of the biggest obstacles to a greater flow of technology from the Japanese government to developing countries is not a scarcity of relevant know-how but a lack of human/administrative resources to distribute the aid. Foremost, Japan's foreign aid program is understaffed (see *JEI Report* No. 45A, December 6, 1991). An increase in training programs in Japan has bolstered technology transfers (see *JEI Report* No. 7A, February 21, 1992), but progress remains slow in Tokyo's efforts to encourage corporate Japan to boost technology transfers to poor developing countries.

- Basic Research - This is another area where Tokyo's rhetoric is ahead of reality, although the gap is closing. Aggregate spending data show little change, so far, in the division of Japan's R&D pie among basic, applied and developmental research. Outlays for basic R&D programs, such as the Human Frontiers Science Project — which explores basic body and brain functions, are expanding at a healthy pace. Moreover, initial budget requests for FY 1993 indicate that the Ministry of Education remains intent on upgrading the nation's university laboratories.

A point worth raising is that the meaning of "basic" research is different in Japan than it is in the United States or Europe. Japanese basic research often is aimed at finding basic uses for products, not at developing an understanding of the fundamental science that lies behind a particular phenomenon. Japanese scientists and science policy planners are debating this difference, but it is unlikely that the Japanese definition will move much closer to the American or European standard. In fact, the Japanese see their interpretation of basic R&D as something they can contribute to the world precisely because it often does lead to tangible benefits.

- Internationalization of Japanese R&D - Not only does internationalization imply external ties to foreign research resources and a research presence overseas but invitations to foreigners to engage in or become aware of work within Japan as well. Internal efforts include: the promotion of activities for foreign researchers in Japan, wider dissemination of Japanese research and the elimination of distinctions between Japanese and foreign research activities, at least insofar as government calls for bids. Politics, both domestic and international, plays an inordinately large role in this area, causing problems and obstacles more often than not.

- Human Frontiers Science Program - This well-established project exploring the basic biochemical functioning of the human brain and body is attracting research grant applicants from around the world. While both STA and MITI boosted program funding this year, the number of researchers and funded projects has reached expected levels; funding is likely to plateau as a result.
- Human Genome Project - Proposed by American scientists in 1985, HUGO aims to map the genetic information of 30 individuals over the next 15 years at a cost of about $3 billion. Tokyo's response continues to be lukewarm. While STA has budgeted about $8 million for the project, other agencies have shown little interest.
- Superconducting Super Collider Project - The SSC will use an unprecedented number of superconducting magnets to smash protons together in an effort to understand the fundamental nature of matter and energy. The giant accelerator will cost an estimated $8.5 billion ($11 billion by private estimates), for which Washington hopes to get foreign coverage of one-third. Japan and other allies have been approached to contribute in exchange for access to the facility. The recent House of Representatives' vote to cease funding the SSC has decreased the likelihood that Tokyo can be coaxed to join.
- Intelligent Manufacturing System - First proposed by MITI in late 1989, IMS is a universal computer standard to handle the design, production and distribution of goods. MITI invited American and European companies to participate, but Washington and Brussels insisted that the project be handled at the government-to-government level. After more than two years of talks, the three sides are moving to begin cooperation in limited areas, such as communications specifications. Many details remain to be worked out, and IMS likely will go forward in a form far different from what Tokyo originally envisioned.
- Real World Computing Project - MITI envisioned this successor to its much-heralded "Fifth Generation" computer project as a multinational affair. It also has become a topic of government-to-government negotiations that have stretched its time horizon. As with IMS, Washington and Tokyo have agreed to limited cooperation on specific research topics as a test case before proceeding with full-fledged joint research. The first pilot topic is a test module for evaluating optoelectronic components.
- Government-Industry Joint R&D - To encourage foreign participation Tokyo liberalized the rules for joint research projects, with particular attention paid to an equitable sharing of resultant intellectual property rights. After an initial rush in FY 1991, however, foreign interest in new public-private research projects has cooled. It may be that foreign companies are waiting to join pending their evaluation of the experiences of foreign firms that already have signed up for projects.
- Private Efforts - Faced with the twin challenges of path-breaking basic research and a dwindling supply of Japanese scientists, Japanese companies are adopting a global view for their research efforts. Foreign scientists and engineers are being hired under short- and long-term conditions to staff and lead domestic projects. At the same time some firms are setting up R&D centers overseas with both local and Japanese staffing. While the numbers still are small, Japan's corporate R&D community is becoming more internationalized.

"Technoglobalism"

This Japanese-coined term, which describes the next stage of Japan's R&D establishment, encompasses the erosion of national borders with regard to scientific and technical research as well as cooperative, mutually beneficial R&D links among companies and governments. The confluence of four factors has made "technoglobalism" the buzzword for 1992 in Japan's science policy community. Two of the four factors — increasing foreign pressure on Japan to make a positive contribution to global science and technology in addition to the increasingly global scope of Japan's R&D programs — already have been outlined. The remaining two are:

- A reevaluation of the "no holds barred" attitude of Japanese companies toward competition (see *JEI Report* No. 15A, April 17, 1992). Highly competitive Japanese companies have won major shares of markets, generating foreign resentment and protectionist backlashes overseas. Japan's business community is debating whether this dogged competitiveness remains appropriate in today's post-Cold War economic environment. Key business leaders and business groups have called for a more cooperative *modus vivendi* between Japanese and foreign companies. Keidanren (Japan Federation of Economic Organizations), Japan's leading business association, has labeled this "kinder and gentler" business behavior "symbiosis." Cooperative research between Japanese and foreign firms is a key component of this new attitude.

- The current Japanese economic downturn has shaken the confidence of many Japanese companies in their ability to survive independently in the increasingly competitive global economy. Falling profits, increasing capital costs, stumbling domestic equity markets and rising research, product-development and manufacturing costs and risks have made strategic alliances and joint R&D projects with foreign firms much more attractive to Japanese companies.

In many ways the private sector has been pursuing "technoglobalism" for decades without any encouragement from the government. Fuji Photo Film Co., Ltd. and Xerox Corp. plus Hewlett-Packard Co. and Yokogawa Electric Corp. long have had productive joint ventures. Even joint ventures of recent vintage are announcing positive results, indicating cooperative rewards without decades-long relationships. International Business Machines Corp. and Toshiba Corp., for example, have codeveloped and are manufacturing active-matrix liquid-crystal display screens for laptop computers. By pooling their financial and technical resources, the two partners have raised output yields of the difficult-to-make displays to the 50 percent-range, according to Japanese press reports. Among the industries in the midst of restructuring with the global marketplace in mind:

- The Japanese, American and European automotive industries increasingly have become intertwined via joint development, design, production and research agreements. Many analysts predict that the global industry will undergo a major consolidation in the next decade as national markets are liberalized and production becomes internationalized.
- Electronics and computer companies also are becoming less concerned with national borders and more focused on the global marketplace. In recent months foreign and Japanese companies once considered archrivals have announced joint research, development and production agreements. The rapidly escalating costs of developing new generations of microchips and building production facilities are propelling companies to pair up. Many analysts expect future competition to be between multinational groups of companies rather than between groups of firms from one country.
- The emerging field of multimedia has taken on an international cast. Japanese companies are offering their hardware expertise in combination with foreign firms' software know-how to get in on the ground floor of this new industry, which seamlessly melds digital sound, text, graphics and video.

MITI has welcomed the growing internationalism of the Japanese business community but wants to ensure that the nation's scientific community is drawn into the process. This year's industrial technology white paper and several advisory bodies have examined the meaning of "technoglobalism" with regard to government R&D policies. Along with encouraging and accommodating international alliances among firms, the main thrust of this exercise is Tokyo's preparation to contribute to the globalization of science by supporting Centers of Excellence in Japan and abroad. These centers would support leading-edge basic and precommercial research by funding grants, support staff, laboratory facilities and housing. The COEs would foster the exchange of ideas amid many scientific disciplines and among researchers from around the world.

While the goals of COEs look worthwhile on paper, many practical problems impede its realization. MITI's outline does not clearly specify which agency will control the centers, how they will be funded and where they will be located. The Ministry of Education, which is trying to strengthen the national university system to become a "center" of topflight basic research, almost surely would have trouble with MITI's plan. Given the poor reception by foreigners of previous MITI initiatives aimed at international participation, foreign official support for COEs is not likely to be enthusiastic, at least at the outset. The political nature of these problems and other logistics cloud the future of "technoglobalism."

Conclusion

The well-funded, vigorous Japanese research effort ensures that Japanese industry will remain internationally competitive well into the next century. Japanese research policies do not exist in a vacuum, however, and fundamental changes in the global economic and political environment are driving realignments. As an important component of its bid to bear greater international responsibilities, Tokyo has pledged that Japan will become a net contributor to the world's storehouse of basic and applied knowledge. The small steps in this direction, as reflected by changes in government and private research budgets, show that this pledge will be achieved — but only over a long period of time.

Equally important to the success of Tokyo's campaign is the attitude of foreigners toward Japanese cooperative research initiatives. If Tokyo's multinational projects continue to be met with skepticism and suspicion (whether or not it is deserved), Japan will be unable to carve out a larger international role for itself. Similarly, Tokyo's response to multilateral initiatives from overseas has an important impact on the climate surrounding Japan's effort to play a more active international role.

While Tokyo debates policy, domestic companies also are debating new directions in R&D. Intensifying global competition combined with greater financial and technological risks are driving Japanese companies to reconsider their business priorities. One result of this reevaluation is a growing number of R&D partnerships with foreign firms, the first concrete signs of a trend toward "technoglobalism." Development of this trend could either mute or exacerbate the frictions over high technology that currently plague Japanese commercial and political relations.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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Rising Japanese Trade Surplus Obscures Underlying Trends

Appearances can be deceiving. That seems to be at least one lesson from Japan's latest customs-clearance trade statistics, released July 13. The dollar-denominated trade surplus, which jumped 35.6 percent in the April-June period compared to a year earlier (see Tables), raised the uneasy sense in Tokyo and Washington that Japan's external imbalances are political dynamite that could explode at any time. The bilateral aspect of the problem — of particular concern during a presidential election year — was underscored by the 36.7 percent jump in the dollar surplus in Japan's trade with the United States. That was the fourth straight quarterly increase in the bilateral surplus compared with six consecutive quarterly gains in the worldwide dollar-denominated imbalance.

Closer examination of the quarterly figures, however, brings to mind an onion more than a bomb; peeling away successive layers leaves little of substance. The yen-denominated figures reflect the results of trimming away the outer layers. The difference in the representation of the dollar- versus the yen-denominated trade statistics corresponds to the approximate effects of currency movements. The yen appreciated between 5.1 percent (for imports) and 5.3 percent (for exports) in

Table 1: **Japan's Total Trade in Dollar Terms**

(in millions of dollars)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1987		$229,221	9.6%	$149,515	18.3%	$79,706
1988		264,917	15.6	187,354	25.3	77,563
1989		275,175	3.9	210,847	12.5	64,328
1990		286,948	4.3	234,799	11.4	52,149
1991		314,525	9.6	236,737	0.8	77,788
1990:	I	66,705	-2.2	54,383	6.3	12,322
	II	67,232	-0.5	53,954	5.2	13,278
	III	72,189	3.7	56,547	6.6	15,642
	IV	80,822	15.9	69,914	26.3	10,908
1991:	I	76,338	14.4	61,869	13.8	14,469
	II	73,992	10.1	56,283	4.3	17,709
	III	79,065	9.5	57,097	1.0	21,968
	IV	85,131	5.3	61,487	-12.1	23,644
1992:	I	82,444	8.0	57,429	-7.2	25,015
	II (p)	80,834	9.2	56,816	0.9	24,018

Table 2: **Japan's Total Trade in Yen Terms**

(in billions of yen)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1987		¥33,315	-5.6%	¥21,737	0.9%	¥11,578
1988		33,939	1.9	24,006	10.4	9,933
1989		37,823	11.4	28,979	20.7	8,844
1990		41,457	9.6	33,855	16.8	7,602
1991		42,360	2.2	31,900	-5.8	10,460
1990:	I	9,766	12.2	7,941	21.9	1,825
	II	10,449	13.3	8,392	19.9	2,057
	III	10,651	7.5	8,364	10.8	2,287
	IV	10,592	6.1	9,159	15.7	1,433
1991:	I	10,183	4.3	8,257	4.0	1,926
	II	10,225	-2.1	7,775	-7.4	2,450
	III	10,853	1.9	7,846	-6.2	3,007
	IV	11,099	4.8	8,023	-12.4	3,076
1992:	I	10,523	3.3	7,317	-11.4	3,206
	II (p)	10,608	3.7	7,467	-4.0	3,141

Table 3: **Japan's Trade with the United States in Dollar Terms**

(in millions of dollars)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1987		$83,580	3.9%	$31,491	8.4%	$52,090
1988		89,634	7.2	42,037	33.5	47,597
1989		93,189	4.0	48,246	14.8	44,943
1990		90,322	-3.1	52,369	8.5	37,954
1991		91,538	1.3	53,317	1.8	38,220
1990:	I	21,661	-4.7	12,753	9.9	8,908
	II	20,938	-9.0	12,861	6.6	8,077
	III	22,933	-4.9	12,729	2.1	10,204
	IV	24,790	6.2	14,025	15.7	10,765
1991:	I	22,311	3.0	13,268	4.0	9,043
	II	20,304	-3.0	13,464	4.7	6,840
	III	23,719	3.4	13,185	3.6	10,534
	IV	25,205	1.7	13,401	-4.4	11,804
1992:	I	22,771	2.1	13,528	2.0	9,243
	II (p)	22,106	8.9	12,759	-5.2	9,347

Table 4: **Japan's Trade with the United States in Yen Terms**

(in billions of yen)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1987		¥12,148	-10.4%	¥4,582	-6.8%	¥7,566
1988		11,487	-5.4	5,388	17.6	6,099
1989		12,816	11.6	6,632	23.1	6,184
1990		13,057	1.9	7,586	14.4	5,471
1991		12,324	-5.6	7,191	-5.2	5,133
1990:	I	3,171	9.4	1,862	26.0	1,309
	II	3,254	3.7	2,000	21.4	1,254
	III	3,384	-1.5	1,885	6.3	1,498
	IV	3,249	-2.8	1,838	6.1	1,411
1991:	I	2,977	-6.1	1,770	-4.9	1,207
	II	2,806	-13.8	1,860	-7.0	946
	III	3,255	-3.8	1,812	-3.9	1,443
	IV	3,287	1.2	1,749	-4.8	1,538
1992:	I	2,905	-2.4	1,725	-2.5	1,180
	II (p)	2,902	3.4	1,677	-9.8	1,225

the year from the second quarter of 1991. As a result, both imports and exports appear inflated in dollar terms, resulting in a scaling up of Japan's trade surplus as well.

Peeling away the exchange-rate effect still leaves a substantial onion, however. The overall yen-denominated imbalance grew 28.2 percent between the April-June periods of 1991 and 1992. More ominously from a foreign perspective, Japan's worldwide exports grew over the year, while imports declined. For U.S. economic policymakers, who have labored hard to increase access for American products in Japan, the drop in imports from the United States — by either the dollar or the yen measure — has to be particularly frustrating. The fact that the Japanese economy, by most accounts, was sinking deeper into a recession during the spring may explain the apparent weakness of imports. However, these trends would appear to support an argument often heard about the Japanese economy: faced with economic difficulties, Japanese firms reduce imports and expand exports in an effort to trade their way out of recession.

The inner core of the trade statistics onion reveals that this argument is not correct, at least for the April-June quarter. During this period Japanese exporters reacted in atypical fashion to the yen's appreciation. Rather than cutting their prices in yen — as they have done during past periods of upward pressure on the Japanese currency — and thereby raising the prices charged in dollars by less than the currency change, Japanese exporters did the reverse and increased prices in yen by nearly 2 percent compared to a year earlier. (Export pricing behavior has been the subject of intense political and academic controversy. For details, see *JEI Report* No. 43A, November 15, 1991.) Hence, the dollar-denominated quarterly export figure represented the cumulative effect of currency changes, price increases in yen terms and rises in the volume exported, the last of which came to 2.1 percent on a year-to-year basis. Put differently, more than three-quarters of the jump in dollar-denominated exports in the April-June period resulted from price rises reflecting both the cheaper dollar and the higher yen prices. In short, the decision of Japanese exporters to raise prices rather than try to maintain share in foreign markets made the dollar-denominated trade surplus worse than it otherwise would have been from the perspective of those hoping for a smaller imbalance.

In contrast to export prices, the cost of imports in yen terms fell almost 7 percent in the second quarter. As a result, the volume of imports rose 2.9 percent despite the lower dollar- and yen-denominated figures. Inasmuch as the increase in import volume exceeded the real increase in exports, the price-adjusted trade balance actually fell by 0.5 percent from its April-June 1991 level. Peeling away the onion's layers in this fashion results in Japan's apparently dramatic trade surplus increase disappearing entirely. Politicians on both sides of the Pacific will have to determine whether the trade surplus onion, if they choose to employ it as a grenade in subsequent bilateral disputes, might fall apart in their hands.

Douglas Ostrom

Foreign Direct Investment In Japan Jumps

Foreigners investing in real assets in Japan over the 12-month period ending March 31, 1992 set several new records, highlighting the increasing international importance of the Japanese economy as well as the growing interest among foreigners in penetrating Japanese markets. After taking a backseat to investors from the Netherlands in FY 1990, U.S. companies recaptured the title of top direct investors by more than doubling the amount of money they put into Japan in FY 1991. European direct investments as a group, however, continued to outpace those by Americans in both number of cases and value. The rapidly growing Japanese services sector apparently appeared far more lucrative to foreign investors in FY 1991 than the year before, a trend that likely will continue as the Japanese economy matures.

According to data compiled by the Ministry of Finance, foreigners poured more than $4.3 billion into new Japanese direct holdings in FY 1991, easily setting a record (see Table 1). Net direct

Table 1: **Trends in Foreign Direct Investment in Japan, FY 1951-FY 1991**

(number of cases and millions of dollars)

Fiscal Year	Equity Capital		Loans and Bonds		Total		Direct Investment Liabilities*
	Cases	Amount	Cases	Amount	Cases	Amount	
1951-80	8,826	$2,979	n.a.	n.a.	8,826	$2,979	n.a.
1981	919	432	n.a.	n.a.	919	432	$151
1982	1,052	749	n.a.	n.a.	1,052	749	492
1983	2,363	813	n.a.	n.a.	2,363	813	403
1984	3,685	493	n.a.	n.a.	3,685	493	14
1985	3,322	780	48	$150	3,370	930	705
1986	3,045	760	34	180	3,079	940	443
1987	3,912	1,453	34	761	3,946	2,214	463
1988	4,236	2,576	32	667	4,268	3,243	-287
1989	5,638	1,941	50	919	5,688	2,860	-286
1990	5,902	2,585	37	193	5,939	2,778	1,124
1991	4,141	3,164	71	1,175	4,212	4,339	2,202
Cumulative	47,041	18,725	306	4,046	47,347	22,771	n.a.

*Long-term capital flow (net) on a balance of payments basis.

Source: Ministry of Finance and Bank of Japan

investment transactions by foreigners also hit a new high in FY 1991 of $2.2 billion, according to balance of payments data collected by the Bank of Japan. In terms of the total number of cases, however, FY 1991's tally of 4,212 was the lowest in four years. The record value combined with the sparser number of transactions yielded an all-time-high average investment value of just over $1 million. The average value of an investment can fluctuate widely from year to year. Since FY 1987, for example, it tracked from $561,075 to $759,841 in FY 1988 but then fell to $502,813 in FY 1989 and subsequently to $467,756 in FY 1990 before shooting up to FY 1991's $1,030,152 level. This zigzag underscores the fact that the aggregate figures are influenced easily by a few large deals.

The preferred financing vehicle continued to be equity inflows, accounting for 98.3 percent of all cases and 72.9 percent of the total value of direct investment. Debt financing, while still small from an overall standpoint, leapt forward in FY 1991, nearly doubling in number and rising sixfold in value.

The influence of a few large deals shows more clearly when foreign investment is broken down by country of origin (see Table 2). American investors, for example, made fewer new investments or acquisitions in FY 1991 than the year before (538 versus 672), but the value of these transactions more than doubled from $664 million to $1.3 billion. While this hiked the U.S. share of FY 1991 foreign direct investment to 30.7 percent, the American number still was well below past marks, which have ranged from 40 to 50 percent. The other big gainers included Canada and the United Kingdom. Investments by the Japanese subsidiaries of foreign firms also surged in FY 1991, both in terms of numbers and value.

The manufacturing sector apparently lost some of its shine in FY 1991, attracting 17.9 percent fewer investments than the year before (see Table 3). While the number of transactions was down, however, the value of foreign investment in manufacturing rose 20.8 percent. More significantly, the manufacturing sector declined in importance relative to the nonmanufacturing sector, with the FY 1991

Table 2: **Foreign Direct Investment in Japan by Country, FY 1990-FY 1991***

(in millions of dollars)

	FY 1990			FY 1991			Cumulative March 31, 1992		
	Cases	Value	Share	Cases	Value	Share	Cases	Value	Share
United States	672	$664	23.9%	538	$1,334	30.7%	8,891	$9,907	43.5%
Canada	53	142	5.1	38	764	17.6	763	1,093	4.8
Netherlands	729	734	26.4	431	323	7.5	3,293	1,787	7.8
Switzerland	364	142	5.1	225	176	4.1	2,867	1,334	5.9
West Germany	345	259	9.3	191	172	4.0	2,564	1,122	4.9
United Kingdom	507	54	1.9	425	431	9.9	4,158	1,083	4.8
France	438	74	2.7	310	51	1.2	2,741	352	1.5
Other Europe	206	98	3.5	190	195	4.5	2,174	670	2.9
Hong Kong	384	62	2.2	227	60	1.4	4,622	575	2.5
Japan**	389	231	8.3	899	639	14.7	4,679	2,721	12.0
Other	1,852	317	11.4	738	193	4.5	10,595	2,127	9.3
Total	5,939	2,778	100.0	4,212	4,339	100.0	47,347	22,771	100.0

*Approval basis. Data exclude disinvestments.
**Investments by Japanese firms with significant foreign participation.

Source: Ministry of Finance

Table 3: **Foreign Direct Investment in Japan by Industry, FY 1990-FY 1991***

(in millions of dollars)

	FY 1990			FY 1991			Cumulative March 31, 1992		
	Cases	Value	Share	Cases	Value	Share	Cases	Value	Share
Manufacturing	2,030	$1,570	56.5%	1,666	$1,896	43.7%	20,450	$13,666	60.0%
Food	74	29	1.0	150	124	2.9	1,354	436	1.9
Textiles	26	18	0.6	4	9	0.2	201	78	0.3
Rubber and Leather	7	1	0.0	6	56	1.3	133	132	0.6
Chemicals	234	438	15.8	120	902	20.8	2,571	4,061	17.8
Petroleum	59	30	1.1	45	173	4.0	569	895	3.9
Nonmetallic Mineral Products	73	6	0.2	132	5	0.1	580	152	0.7
Metals	125	151	5.4	211	79	1.8	1,203	727	3.2
Machinery	886	806	29.0	581	439	10.1	10,855	6,616	29.1
Other	546	92	3.3	417	109	2.5	2,984	569	2.5
Nonmanufacturing	3,909	1,208	43.5	2,546	2,444	56.3	26,897	9,104	40.0
Construction	366	9	0.3	313	23	0.5	1,849	113	0.5
Real Estate	114	24	0.9	33	69	1.6	521	887	3.9
Commerce	2,057	730	26.3	1,315	783	18.1	14,193	3,727	16.4
Services	1,098	263	9.5	685	545	12.6	7,304	1,606	7.1
Transportation	63	12	0.4	63	26	0.6	545	165	0.7
Communications	13	21	0.8	46	99	2.3	159	247	1.1
Banking and Insurance	64	109	3.9	27	890	20.5	338	1,571	6.9
Other	134	40	1.4	64	8	0.2	1,988	788	3.5
Total	5,939	2,778	100.0	4,212	4,339	100.0	47,347	22,771	100.0

*Approval basis. Data exclude disinvestments.

Source: Ministry of Finance

balance shifting from 56.5 percent in manufacturing's favor and 43.5 percent for nonmanufacturing to a near mirror-image balance of 43.7 percent for manufacturing and 56.3 percent for nonmanufacturing. On a cumulative basis, with all investments valued at historical cost, manufacturing retained its dominant position.

These aggregate numbers hide sharp changes in both sectors. Foreign direct investment more than doubled between FY 1990 and FY 1991 in the food, rubber and leather, chemicals, petroleum, construction, real estate, services, transportation, communications and financial industries. Funds flowing into the metals and machinery industries, in contrast, dropped by half or more in FY 1991.

Data combining regional and industry direct investment flows (Table 4) reveal a decided tilt by investors from the Americas and Asia toward nonmanufacturing ventures. Investments by European companies and the Japanese subsidiaries of foreign firms is more balanced between the two major sectors. In FY 1991 the United States accounted for most inward direct investment flows into the machinery and financial industries, whereas Europe was the source of most of the money bolstering the petroleum and commercial industries. Investment in Japan by nations of the Middle

Table 4: Foreign Direct Investment in Japan by Region by Industry, FY 1991*

(in millions of dollars)

	North America		Latin America		Asia		Europe		Japan**	
	Cases	Value	Cases	Value	Cases	Value	Cases	Value	Cases	Value
Manufacturing	169	$776.4	122	$37.7	155	$8.7	739	$735.7	399	$336.2
Food	11	61.7	17	1.1	17	0.1	83	3.3	13	57.3
Textiles	2	8.5	0	0	2	0.6	0	0	0	0
Rubber and Leather	0	0	0	0	0	0	3	55.5	3	0.1
Chemicals	45	323.7	11	35.3	6	6.8	33	386.4	24	150.1
Petroleum	2	0.1	0	0	3	0.0	14	152.0	25	21.0
Nonmetallic Mineral Products	6	0.0	14	0.7	14	0.1	76	3.1	13	0.7
Metals	26	45.1	21	0.1	21	0.1	116	33.3	12	0.5
Machinery	50	301.0	40	0.5	58	0.2	263	90.7	140	46.6
Other	27	36.4	19	0.1	34	0.8	151	11.5	169	59.8
Nonmanufacturing	407	1,321.5	155	66.8	344	134.0	1,033	612.7	500	303.2
Construction	20	0.5	22	0.9	54	1.4	165	6.3	31	13.3
Real Estate	6	23.7	2	7.1	6	20.3	9	16.4	9	1.2
Commerce	200	139.8	76	34.8	204	86.6	553	450.3	228	68.2
Services	140	277.3	42	1.7	71	10.1	233	40.9	175	214.2
Transportation	2	2.9	9	21.8	5	0.4	39	0.9	1	0.1
Communications	22	47.1	1	0.1	2	12.4	12	36.3	9	3.3
Banking and Insurance	14	829.5	1	0.1	0	0	8	60.1	4	0.4
Other	3	0.6	2	0.4	2	2.8	14	1.5	43	2.6
Total	576	2,097.9	277	104.5	499	142.7	1,772	1,348.3	899	639.3

*Approval basis. Data exclude disinvestments.
**Investments by Japanese firms with significant foreign participation.

Source: Ministry of Finance

East (120 cases worth $1.3 million), Africa (58 cases worth $1.2 million) and Oceania (11 cases worth $3.8 million) continued to be comparatively insignificant. (It should be noted that some investment from the Netherlands, Hong Kong and Latin America represents funds channeled through tax havens from other countries. Middle Eastern investors, therefore, may be investing sizable sums of money in Japan but getting tax benefits by using Panamanian or Dutch financial institutions.)

While FY 1991 was a record-setting year for foreign direct investment in Japan, this inward flow continued to be dwarfed by the Japanese direct investment overseas. (For the most recent figures, see *JEI Report* No. 23B, June 19, 1992.) Since a greater foreign presence in Japan is considered by both Tokyo and its trading partners to be a long-term solution to trade and investment frictions, this disparity remains a source of concern.

Jon Choy

U.S., Japanese Businessmen Air Differences Of Opinion

In July 12-14 discussions in Tokyo top corporate executives from Japan and the United States uncovered significant differences regarding each other's expectations for what their bilateral business forum could achieve. Against the backdrop of this country's worsening deficit with its number-two trading partner, a deficit running at a yearly level of $44.3 billion through the first five months of 1992 in comparison with the $43.4 billion in 1991, American business leaders urged their Japanese counterparts at the 29th annual meeting of the U.S.-Japan and Japan-U.S. Business Councils to take more concrete action to narrow the trade imbalance. For their part Japanese participants focused on long-term or broader macroeconomic issues, such as the global economic situation, the multilateral trading system and the harmonization of corporate management between the world's two leading economies. Gaishi Hiraiwa, chairman of Keidanren (Japan Federation of Economic Organizations), for example, stressed in his keynote speech that Japan must make macroeconomic policy changes, such as those outlined in its new five-year economic plan (see *JEI Report* No. 26B, July 10, 1992), as well as proceed with sectoral solutions to curb the widening transpacific trade imbalance.

In recognition of the U.S. emphasis on improving American access to Japanese markets, particularly in the services sector, the joint closing remarks referred to the potential for unspecified market access issues to disrupt the U.S.-Japan economic relationship. Seconding this perception, TRW Inc.'s Joseph Gorman, the new chairman of the U.S.-Japan Business Council, stressed, "We cannot stay on our current path of rising trade deficits. . . . [Without] significant and measurable actions, [we cannot] achieve a breakthrough."

The two delegations, headed by John Marous, former chairman of Westinghouse Electric Corp., and Eishiro Saito, Keidanren's honorary chairman, backed formation by the councils of bilateral task forces to deal with specific issues where no better mechanism exists. The first step will be to establish a group on the services sector. Other proposed task forces would deal with government procurement and foreign direct investment, if necessary.

Both countries' business leaders disclaimed any preference for managed trade, but they reconfirmed a joint resolution issued by the two councils last February in which Washington was called on to draft an "export vision" and Tokyo an "import vision" (see *JEI Report* No. 8B, February 28, 1992). Mr. Gorman stressed, "The visions rely on government leadership to set exports and imports as national priorities for the United States and Japan." In line with the focus on an export vision for this country both councils agreed to hold a symposium on American exports to Japan in Washington in October. The Department of Commerce has said it will give its full support to the meeting.

The American and Japanese business leaders also discussed international environmental protection issues outside of the formal annual meeting. Unlike more complicated bilateral issues, the global topic drew a shared perception of its importance from corporate executives on both sides of the

Pacific. They agreed to encourage scientific research on environmental issues by each country's government and private sector. Calling the exchange of information on global environmental issues between the two countries an important step, both groups of businessmen acknowledged the necessity of providing people with accurate information and facts on environmental matters. Council members also said they would act as role models on environmental protection.

Tadashi Saito

Miyazawa, LDP Political Prospects Brighten For Upper House Elections

Prime Minister Kiichi Miyazawa, like his predecessor, Toshiki Kaifu, may surprise critics with his political longevity. As politicians of all persuasions geared up for the July 26 upper house elections, the ruling Liberal Democratic Party appeared assured of securing a little more than half of the 127 seats at stake. Mr. Miyazawa, in turn, seemed certain of hanging on to the reins of government — at least until the end of the year, if not for his full two-year term. This represents an important turnaround for a leader who, although skilled in diplomacy, seemed to encounter one domestic setback after another during his initial months in office (see *JEI Report* No. 10B, March 13, 1992). Some analysts have attributed Mr. Miyazawa's improved fortunes to luck and timing; others have said he shrewdly engaged ruling party politicians not only to unify the party but to forge key alliances with certain of the opposition parties as well. In any event, Mr. Miyazawa and his LDP colleagues appeared to be on much sounder political footing than many had expected as they faced the first national election since the prime minister won office in late October 1991.

The upper house elections are important for the LDP; the vote is the first nationwide opportunity for the ruling party to begin to rectify the damage incurred three years ago when voters denied to the LDP for the first time its majority in the upper house. The electorate used the July 1989 upper house elections to express via the ballot box its disaffection with the ruling party's brand of "money politics," as exemplified by the Recruit Co., Ltd. influence-peddling scandal. Also factoring in were voter irritation at the LDP government's June 1988 decision to liberalize beef and orange imports and the April 1989 implementation of a 3 percent consumption tax (see *JEI Report* No. 32A, August 18, 1989). Losing control of the House of Councillors has forced the LDP to form issue-specific coalitions with certain opposition parties (usually Komeito and the Democratic Socialist Party, the two centrist opposition parties) in order to enact key, nonmoney legislation. As was apparent by the protracted nature of the LDP's dealings with Komeito and the DSP to secure enactment of a bill that authorizes the overseas dispatch of Self-Defense Forces for United Nations-sponsored peacekeeping operations, coalition-building has proved difficult and has not lent itself to expeditious policymaking (see *JEI Report* No. 23B, June 19, 1992).

LDP Vice President Shin Kanemaru kicked off the campaign season July 8 by declaring that the ruling party wants to "stabilize" Japanese politics by narrowing the gap between the LDP and the opposition parties in the upper house. Half of the 252 seats in the House of Councillors are chosen every three years; this year, though, 127 seats are being contested because of former upper house president Yoshihiko Tsuchiya's successful run last month for governor of Saitama prefecture. The LDP now holds 116 upper house seats, of which 77 are up for reelection. To reclaim control of this chamber the LDP needs to add 88 seats to the 39 not up for election. This is impossible since the ruling party is fielding only 82 candidates (see Table). Most political experts also doubt that all 77 LDP incumbents can win. The largest number of seats the ruling party has ever won in an upper house election is 72, a goal the LDP achieved six years ago when both houses were dissolved for elections. Ruling party officials therefore have set a more modest — but, they say, achievable — goal of winning 64 seats.

Although securing 64 seats would lower the LDP's total representation in the upper house to only 103, such an outcome, LDP strategists contend, would allow the party to declare itself well on the way to regaining control of this chamber in the 1995 contests. It also would represent the public's

Upper House Candidates By Party

	Seats Contested		Seats Not Contested
Liberal Democratic Party	82	(77)	39
Social Democratic Party of Japan	43	(22)	47
Komeito	23	(10)	10
Japan Communist Party	71	(9)	5
Rengo	22	(1)	12
Democratic Socialist Party	20	(5)	3
United Social Democratic Party	9	(–)	1
Minor Parties	332	(–)	3
Independents	39	(3)	5
Total	641	(127)	125

Note: Incumbents shown in parentheses.

endorsement of the U.N. peacekeeping support bill, these analysts say. Opinion polls present differing pictures as to how solidly the Japanese public endorses the concept of dispatching Japanese military personnel abroad. A recent Kyodo News Service poll revealed that about 70 percent of the respondents plan to take into consideration the Diet's action on the peacekeeping support bill when they go to the polls. Moreover, 53 percent said they were against the legislation, with only 44 percent expressing support.

As expected, the Social Democratic Party of Japan has made enactment of the peacekeeping support bill the central election issue. The SDPJ, the Japan Communist Party and other opponents of the bill are hoping to draw support away from the LDP by tapping into still strong pacifist sentiments at the grass roots in the belief that many Japanese agree that the bill exceeds the limits of Japan's "peace constitution." Judging by SDPJ chairman Makoto Tanabe's remark that "political reform never will be achieved under the Miyazawa cabinet," the Socialists also may try to rekindle voter's negative feelings toward the ruling party as a result of the Recruit affair as well as a more recent scandal involving Mr. Miyazawa's association with Fumio Abe, a former faction member who was arrested on bribery charges (see *JEI Report* No. 7B, February 21, 1992).

The opposition parties, however, do not have a pristine image among voters either. Some political commentators have discounted polls on the peacekeeping bill's lack of support by pointing out that the televised SDPJ-led filibuster tactics during Diet debate on the legislation hurt the SDPJ's efforts to cultivate an image of a party providing a credible leadership alternative. Also, during an economic downturn, such as the one currently affecting Japan, voters in the past have been uneasy about giving a stronger hand to opposition groups, which have yet to offer a comprehensive plan that can match or exceed the LDP-led government's postwar management of the economy. The Japanese public, therefore, tends to stick with the LDP.

Mr. Miyazawa will be the leading beneficiary of a strong showing by the ruling party in the July 26 contests. Some observers contend that the LDP's success in securing the "magic" 64 seats could assure the prime minister an uninterrupted two-year tenure. This certainly is not how the picture appeared earlier this year. Back-to-back defeats of LDP candidates in upper house by-elections early this year cast doubt on Mr. Miyazawa's tenure (see *JEI Report* No. 7B, February 21, 1992). Last March some pundits declared that Mr. Miyazawa's days at the helm were numbered due to the Abe scandal as well as to the prime minister's inability to affect timely Diet action on the FY 1992 budget and other important legislation.

By early July, however, the former finance minister and leader of the third-largest LDP faction had regained some political strength. His stewardship through the Diet of the peacekeeping support bill did much to bolster his standing within the LDP and with the public. Kyodo News Service opinion polls show a progressive improvement in public support for Mr. Miyazawa and his cabinet. Only 24 percent of the respondents backed the prime minister when they were polled in March; this figure rallied to 33 percent following Diet enactment of the peacekeeping support bill. Mr. Miyazawa's participation at the July 6-8 summit in Munich, Germany of the world's seven major industrial democracies and, particularly, his success in securing language in the political communique that urged resolution of Tokyo's long-standing dispute with Moscow over a joint claim to four islands north of Hokkaido burnished his image as a global leader.

Political commentators also point out that Mr. Miyazawa's decision to involve in the party leadership structure some key members of the largest LDP faction, named for former Prime Minister Noboru Takeshita, helped him to rebound. In January he appointed Mr. Kanemaru LDP vice president. Not long after that he made Sieroku Kajiyama chairman of the Diet Affairs Committee, a key post managing relations with the opposition parties; in so doing Mr. Miyazawa replaced a member of his own faction. Some analaysts maintain that Mr. Kajiyama's behind-the-scenes work was responsible for forging a LDP/Komeito/DSP agreement on the peacekeeping support bill. The fact that two potential contenders for the prime ministerial post, Foreign Minister Michio Watanabe and former LDP secretary general Ichiro Ozawa, for all intents and purposes are out of the running due to health problems also no doubt has played in Mr. Miyazawa's favor. This is not to suggest that Mr. Miyazawa has completely turned the corner. Should the LDP not fare as well as anticipated in the July 26 elections, the prime minister may not even make it to his one-year anniversary.

Barbara Wanner

Presidential Politics: Perot, Platforms and Protectionism

Political pundits have been scrambling to assess the impact of events surrounding the Democratic National Convention in New York City July 13-16. The week started with Democrats expecting a three-way race for the presidency, pitting the Democratic and Republican candidates against billionaire independent Ross Perot, who had yet to formally announce his candidacy. One of the Democrats' first actions was to adopt a platform that stepped away from the party's traditional stance in some areas. Some analysts have suggested that Mr. Perot's appeal to alienated voters across the nation influenced the platform, which already was headed for a change due to the efforts of Arkansas Gov. Bill Clinton. But before Gov. Clinton formally could accept his party's nomination July 16, Mr. Perot once again changed the course of the campaign by announcing the end of his undeclared presidential bid.

The Texas businessman's pullout, which he said was based on the conclusion that he could not win in November, left his supporters casting about for a substitute. The two major party candidates immediately set out to woo the disaffected group that had propelled Mr. Perot into the lead in national polls this spring. While Democrats and Republicans debated over which faction stood to gain from Mr. Perot's departure, other observers pondered the impact on campaign issues. Some analysts had speculated that Mr. Perot's popularity would pressure his opponents to conform to his line on trade and other topics. Uncertainty often surrounded Mr. Perot's stand on key issues, but many political analysts noted that there was little doubt about his tough tack on trade. Moreover, Japan often was the target of his comments.

Although he has refuted a protectionist label, Mr. Perot told a *Los Angeles Times* reporter this spring that, if elected, his administration would force "the Japanese to say, 'We'll take the same deal on cars we've given you.'" Comments from Perot campaign representatives indicated that the object of his policy was the proverbial "level playing field" but that the likely outcome would be far fewer Japanese imports entering the United States.

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JAPANESE FIRMS GET HELP IN COPING WITH LABOR MARKET SHIFTS

SUMMARY

Competition in a global marketplace is not just among companies but among work forces. Advancing technology requires more specific knowledge or training for at least some workers. In Japan, more than in the United States, the school system turns out graduates well-versed in basic learning skills and teamwork. Through training programs companies foster the concept of teamwork and try to prepare their employees for various job requirements. The government plays a role in this process by offering subsidies for training and encouraging attention to human resource issues.

In a changing employment landscape — in which the services sector is the main job generator, technology is growing more complex, demographic shifts are adding new twists to job planning and diversified sourcing is expanding in a multinational corporate world — other countries are interested in whether Japan's activist approach for educating and training employees helps speed labor market adaptation. Japan's current economic problems and the efforts of employees there to attain a life-style less centered on work may complicate labor market restructuring.

Labor Market Faces Variety of Changes

Japan long has highlighted the importance of education as a means of making the most of its human resources. Like most nations Japan points to people as its most valuable asset, but the country's lack of abundant natural resources underscores this truism. Harvard University economist Dale Jorgenson has calculated that improvements in the quality of labor boosted real Japanese economic growth by a full 1 percentage point each year between 1960 and 1979.[1] Since education served Japan well in developing an industrialized society, a logical correlation suggests education and worker training would be cornerstones for adapting to labor market changes associated with the growing importance of service industries as employers, the internationalization of many corporations, demographic shifts and other less predictable forces. The Democratic Party has made this assumption in the United States by urging government involvement in education and training as a way of helping to satisfactorily maintain or provide good jobs at home (and the associated high standard of living) for all those seeking work.

Government involvement in addressing the transitions of a dynamic economy has potential pitfalls. The Bush administration's explanation of its aversion to industrial policy is that government is not in the business of picking winners and losers. Market forces may be better at identifying areas necessary for adjustment than government policymakers, this theory holds. Critics of this approach point out that some planning is necessary, however. To address the long-term aging of the labor force and an expected shortage of workers in the prime of life, for example, Japan has encouraged training of the older worker so that he or she could be employed suitably into the future. Implementation, however, remains in the hands of corporate actors who have the final say in deciding what type of training is most suited. In Japan's case the government sets guidelines and offers subsidies for training, but the frontline players decide the course of action.

As long as workers are adequately educated in Japan and additional training increases productivity within the firm, Japanese corporations will have an incentive to continue to employ high-skilled workers at home while shifting jobs with low-skill content abroad. The accelerated movement of production overseas was one method of business restructuring that followed the revaluation of the yen in the second half of the 1980s (see *JEI Report* No. 9A, March 6, 1992). The spread of multinational corporate operations and the efforts by Japan's trading partners to open markets, including for foreign direct investment, means that moving more jobs offshore will continue to be an option for businesses in Japan as elsewhere. Worker education and training will be among the primary tools used to adapt to labor market shifts as economies and societies undergo change.

Education System Focuses on Basics

Japan's teamwork approach to fielding a work force — in which responsibilities devolve to the worker for learning, the schools for instilling fundamental knowledge and cooperative-style work habits, the government for setting school standards and workplace training policies and the company for continued training — offers flexibility to a labor market assailed by change. The system that serves at least three-quarters of the high school-age population tends to produce a generalist; this product, grounded in basics, gives employers the opportunity to then provide the training necessary to the specific tasks at hand. Such an option coincides neatly with a work world in which changes are happening quickly. By not expecting workers to have all their training before they enter a company, corporate Japan acknowledges its role in providing continuing education to meet the higher degree of complexity arising in a society bombarded with information and technological changes.

The litany of what's right with Japan's education system is familiar and bears only brief mention for how it prepares students for the work world. Most often cited is the high degree of literacy and numeracy achieved by the average high school graduate. Although analysts point out that the brightest students from around the world might be generally comparable, the achievements of Japanese students on average are recognized as outpacing the averages in most other developed countries, including the United States.

What this means for a potential employer is that a Japanese high school graduate most likely has basic skills in reading, writing and mathematics. While this might seem an obvious assumption, a 1990 report by the Office of Technology Assessment noted that in the United States, "Even among those who graduate from high school ... the bottom third academically are poorly prepared for work." The study further said that deficiency in basic skills affects as much as 20 percent of the work force of

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some firms.[2] Thomas Rohlen of Stanford University has suggested that the length of the school year in Japan and the number of hours spent in academic pursuits during the school day and at night on homework provide what could be equivalent to four additional years of schooling, about the same amount of time needed to obtain a bachelor's degree from an American college.[3]

Along with the grounding in basics another important contribution of the Japanese school experience to employee formation is the emphasis on cooperative efforts. Students are urged to work together to arrive at answers in Japanese schools, an experience that is said to familiarize them with developing unanimity of purpose and group cooperation. A U.S. commission of business and education leaders described these as important attributes for employees of the 1990s. In *What Work Requires of Schools*, a 1991 report for the Department of Labor by the Secretary's Commission on Achieving Necessary Skills, participants cited the importance of employees having good interpersonal relations, including the ability to work as part of a team and teach others skills. The focus by Japanese schools on group effort, which stymies development of "star" players, also has its share of critics, who say that the process submerges individualism, which they usually link to creativity. Other school-derived socialization lessons, valued at least by Japanese companies, include the importance of hierarchy, with older students helping younger ones in school clubs, for example.

A much-studied, often-criticized component of the Japanese school system is the use of examinations to decide who gets into the most prestigious schools. In past and current practice major corporations and the government target their recruiting on the most esteemed universities. The system shapes not only what is taught (whatever the exams are expected to contain) but who generally will run the country in the ensuing generation. Essentially the exams stratify the future ranks of workers. Students with advanced learning abilities will strive to compete for the highest exam scores, while those with less ability will accept a lower strata. Exam-taking starts early (prekindergarten in some cases), but the most critical are those for college. What these exams signal to corporations is not necessarily intelligence or creativity but diligence and ability to learn. One Japanese engineer speaking to a gathering of U.S. and Japanese colleagues quipped that many firms considered the results of the college entrance examinations sufficient data on which to base hiring; the college education, itself, had less value because companies would convey the specific training needed by employees.[4] In this way the government policy that established entrance examinations for public universities (a policy followed by private schools as well) helps companies target their recruiting efforts for what they see as the most desirable, educable employees.

The Path Least Taken

Not everyone tests well. For these students or those who want to specialize — about one-fourth of the Japanese high school population — various vocational programs are available. Not all these students will enter an occupation that corresponds to their training; nevertheless, they tend toward the category of specialist. About one-third of those who bypass enrollment in academic high schools attend what are termed technical schools; the rest enroll in either a commercial (clerical), home economics, agriculture, fishery, nursing or other type of training institution. Even at technical high schools almost 60 percent of the time is spent studying general subjects similar to those in a regular high school. Nearly all the rest of the course work focuses on practical training (15 percent) or special courses (about 22 percent).

Another possibility for those on the nongeneralist path is a vocational training center, established by local governments under the auspices of the Ministry of Labor. Students seeking basic instruction at these institutions, which also offer redevelopment training and skill upgrading to those already in the work force, spend about 6 percent of their time on general studies, slightly less than one-fourth on basic practical training, about 45 percent on applied training and about one-fourth on special courses. While both the Ministry of Education and the Ministry of Labor have vocational programs serving those who have not worked before, the MOL schools more often enroll workers in need of retraining or seeking to upgrade skills (82 percent of the slots available in 1990 were devoted to providing the latter services).

Also serving specialization seekers are 62 technical colleges operating under the Ministry of Education; most of the schools concentrate on engineering subjects. A provision for students at these technical colleges to transfer to a university engineering program has enhanced the image of these schools, according to a study by David Cairncross and Ronald Dore of the Japan-Europe Industry Research Centre.[5] This option indicates broader recognition in Japan of a necessity for specialized education and training.

What happens to workers with specific technical training in times of economic adjustment is as important as what happens to those with a general education. One U.S. study indicates that reemployment opportunities for people with specific skills is less than for those with general skills. Writing in the 1987 *Industrial and Labor Relations Review*, University of Massachusetts professors Michael Podgursky and Paul Swaim noted that "narrow vocational training is a risky investment" for U.S. workers seeking to be reemployed.[6] The effect on Japanese seeking work initially or seeking reemployment is less clear. However, a 1980 survey of firms intending to recruit those just out of school for technical jobs showed that the average respondent weighed "education or training readily applicable to jobs" as the most important criteria (40 percent), followed closely by "general intelligence and adaptability" (39.8 percent). For large corporations the adaptability criteria was most favored (57.4 percent to 31.1 percent for applicable training).[7] Big firms are the companies most likely to need flexibility since they generally have more job rotation; plus they can provide training more easily.

As the technological component of a job increases, however, so does the need for either specialization or expanded education. Companies can adapt either by laying off workers in favor of those with updated training or offering the training through work. Another possibility, to be discussed later, is to hire specialists on an as-needed contract basis. Since most Japanese firms, especially large ones, have not tended to view layoffs as a first choice, job training is a popular option.

Current Training Efforts

Who Provides Training - As many as 70 percent of the Japanese establishments surveyed by the Ministry of Labor in 1991 offered some form of off-the-job training during which employees continued to receive their salary. This off-the-job training is distinct from on-the-job efforts that observers of corporate Japan characterize as almost universal. Least likely to offer off-the-job training are companies employing 30 to 100 people, but a solid majority of these firms (65.6 percent) had such programs in 1991. Not surprisingly, of those firms employing more than 1,000 workers 96.6 percent of the respondents provided some type of training. The finance, insurance and real estate industries ranked at the top of MOL's survey (see Table 1).

Who Receives Training - The extent of training varies according to industry and the expectations of how training will benefit a company. In 1988 a larger proportion of the companies in the finance, insurance and real estate industries provided training to their employees via formal programs than did firms in other industries (see Table 2). Efforts to boost productivity, a common goal across industries, might focus on training managers to streamline production or service. Similarly, technical training can improve workers' familiarity with new equipment and procedures as well as introduce new employees to company practices. The two major recipients of training in most Japanese companies are new recruits and managers, although mid-level technical employees rank high on the list at smaller companies (see Table 3).

Types of Training - The introduction — some might say indoctrination — given new recruits at large corporations often is considered a crucial first step in companies that promote a career-long relationship with employees. At these initial sessions the employer takes a day, several days or a week to outline corporate goals and expectations. Management also hopes to instill company spirit and camaraderie that will encourage employees to link their lives and fortunes to the company. One observer estimated last year that large Japanese companies spend an average of ¥10 million ($74,100 at ¥135=$1.00) for first-year training, which is in addition to the estimated ¥5 million ($37,000) spent on recruiting every year.[8]

In addition to these introductory sessions Japanese recruits typically receive extensive on-the-job training. The early training of new employees is part of a process that supports development of a strong relationship between mentors (superiors) and subordinates; this, in turn, forms the basis of some of the networking ties considered important in corporate Japan. Frequently

Table 1: **Establishments Offering Off-the-Job Training in Japan, 1989 and 1991***

	1989	1991
By Industry		
All Respondents	69.3%	70.0%
Construction	80.6	66.9
Finance, Insurance and Real Estate	83.7	85.0
Wholesale and Retail Trade and Restaurants	62.8	71.7
Services	76.3	80.2
Manufacturing	62.1	66.8
Transportation and Communications	57.4	68.6
By Company Size		
1,000+ Employees	97.3%	96.6%
500-999	94.4	93.6
300-499	88.0	89.5
100-299	80.0	78.1
30-99	63.6	65.6

*Limited to establishments with 30 or more full-time workers that provide training, whether as part of a formal program or on an ad hoc basis.

Source: Ministry of Labor, Human Resource Development Bureau, "Report of a Survey on Actual Conditions of Private Education Training," March 1992.

Table 2: **Establishments With Formal Off-the-Job Training Programs in Japan, 1988***

	To All Workers	To Selected Workers
All Respondents	27.4%	29.8%
Construction	22.0	51.2
Finance, Insurance and Real Estate	60.6	16.6
Wholesale and Retail Trade and Restaurants	28.0	25.2
Services	22.6	22.3
Manufacturing	25.8	34.0
Transportation and Communications	26.9	31.6

*Limited to establishments with 30 or more full-time workers that offer training as part of a human resource plan.

Source: Ministry of Labor, as cited in Toshio Ishikawa, *Vocational Training* (Tokyo: Japan Institute of Labor, 1991), p. 30.

Table 3: **Priorities for Company Training by Selected Career Grades and Ages in Japan, 1984**

	Company Size				
	5,000+ Workers	1,000-4,999 Workers	300-999 Workers	100-299 Workers	30-99 Workers
New Recruits					
New Graduates	65.2%	65.2%	61.1%	49.1%	29.7%
Mid-Career Recruits	1.1	3.7	6.6	11.9	17.0
Mid-Level Workers					
Clerical	13.8	15.8	8.9	8.9	7.9
Technical	19.5	20.9	27.2	30.8	32.0
Production	20.2	23.3	28.6	30.4	31.2
Managers	65.6	55.9	45.0	35.9	27.3
Older Workers	0.7	0.7	0.3	1.0	1.5
Other	1.1	1.0	0.6	0.4	1.4

Note: Participating firms were given the choice of two responses.

Source: Ministry of Labor, as cited in Toshio Ishikawa, *Vocational Training* (Tokyo: Japan Institute of Labor, 1991), p. 23.

cited as an on-the-job practice that promotes familiarity with company functions and personnel is job rotation. At extremes job rotation has functioned to allow corporations to redistribute personnel to areas where they are most needed. Job rotation also is recognized in many companies as a step in the promotion process.

While on-the-job training has an important place in labor force adjustments and productivity growth, major adaptations to labor market restructuring can be found in off-the-job training as well. This can include skill upgrades through company-sponsored workshops or those offered at training centers. Even after-hours meetings of quality control circles to determine how to improve production of a certain item counts as training, at least in some firms. The most expensive form of off-the-job training probably is the overseas study programs offered to selected employees by the government and usually the largest corporations. Selection depends on personnel policies and, at times, on whether an employee is motivated to pursue formal training.

Companies also encourage self-development by their employees, either by helping with tuition costs (an option provided by 78.9 percent of the respondents to a 1989 MOL survey) or allowing time on the job for such pursuits (61.7 percent of respondents). Paid educational leave was least popular, but among those offering such a plan 49 percent allowed time off for up to nine days. An increasing number of enterprises are looking into ways of promoting employee self-development, according to a 1991 report for the Japan Institute of Labor.[9] In this way companies share the cost of educational development (with the employee contributing primarily study time) and also can take note of employee enthusiasm for improving skills or knowledge. The government promotes self-development as well as other company training programs with subsidies.

Who Pays - The money that Japanese businesses put into job training is expected to be returned through improved productivity. As overall productivity has grown, so has the demand for education and training, according to a study by Jacob Mincer of Columbia University and Yoshio Higuchi of Keio University.[10] The industrywide average of what companies pay for training and education as a share of their total labor costs runs about 0.3 percent, based on data compiled in 1985 by the Ministry of Labor (see Table 4). This value may be biased downward because the employment situation at that time was fairly bleak, with only 11.5 openings for every 17 applications. The relative

Table 4: **Expenditures for Education and Training in Japan, 1985**

(as share of total labor costs)

	Company Size				
	5,000+ Workers	1,000-4,999 Workers	300-999 Workers	100-299 Workers	30-99 Workers
Mining	--	0.3%	0.3%	0.1%	0.2%
Construction	0.05%	0.5	0.5	0.2	0.2
Manufacturing	0.5	0.4	0.3	0.2	0.1
Utilities	1.2	1.6	0.4	0.5	0.4
Transportation and Communications	0.2	0.2	0.3	0.2	0.1
Wholesale and Retail Trade	0.2	0.4	0.3	0.3	0.3
Finance and Insurance	0.1	0.3	0.4	0.8	0.2
Real Estate	--	0.2	0.4	0.4	0.2
Services	0.3	0.6	0.4	0.2	0.2

Source: Ministry of Labor, *Yearbook of Labor Statistics 1985.*

availability of workers may have kept training investment lower than normal in that reporting year, although Mr. Mincer has noted that Japanese firms tend to invest more in training during slow periods, presumably because of reduced pressure to maintain production.[11]

Business also receives some help from government in addressing employee training costs. Partially in preparation for the mid-1990s, when the absolute number of workers in Japan is expected to begin shrinking, Tokyo in 1985 amended its Human Resources Development Promotion Law of 1969 to enhance the amount of subsidies offered to companies, particularly small and medium-sized firms, that implement employee training programs. The law specifically encouraged attention to human resource issues in recognition of changes in the labor force brought about by the expansion of the services industry, technological innovations, the aging of the work force and internationalization. Last year the law was amended again. Its five purposes are:

- To encourage companies to set up human resource development programs. The person in charge would draft a development program, give advice and information on educational and training opportunities, plus be a liaison with government on these issues.
- To assist employees' self-development.
- To promote public vocational training.
- To arrange evaluation systems for human resources.
- To enhance international technical cooperation.

Government financial assistance under the human resource development law is available only to those enterprises that have implemented a human resource development plan and participate in the central government's unemployment insurance program. In addition to providing jobless benefits, unemployment insurance premiums fund government vocational training benefits as well as various subsidies for improving employment opportunities for older workers and job development at the local level. Although employees and employers each pay 0.55 percent of total wages as the premium for jobless benefits, companies alone are required to pay an additional 0.35 percent of total wages as a premium to fund training programs and related services. The total 1.45 percent of payroll for unemployment insurance premiums is higher for agricultural, fishery and forestry firms, which contribute more toward jobless benefits, and even higher for construction companies. The latter pays a combined 1.3 percent jobless premium, but companies face a 0.45 percent of payroll costs for the training and service programs.

Among the activities funded by the unemployment insurance program are:

- Human resource development. Eligible costs include operating expenses for in-company group training, entrance and tuition fees for off-site training and wages paid to employees during the training. For companies with fewer than 300 employees (less than 50 workers in the retail and services industries and less than 100 for wholesalers), the subsidy is one-third of the costs. Larger firms can have one-fourth of their costs covered.

Grants for vocational training vary according to an employee's age. The youngest possible recipients are those aged 25 to 34 at small and medium-sized firms assigned to receive specialized training, including for technological advances. The earliest an employee at a larger company becomes eligible for a grant is at age 35; here the money is for training necessary for a job transfer. Workers aged 45 and older are eligible across-the-board for subsidized training that will enable them to keep working after they reach their company's retirement age. Whenever training is aimed at helping employees on the verge of retirement, the subsidies are higher than otherwise. For example, a large firm would be reimbursed for up to one-third of the cost of in-house training (a smaller firm one-half) but only one-fourth (one-third for smaller firms) if the training does not target preretirement employees. The maximum payment per employee also varies with purpose. The smallest expense allowable per worker — ¥50,000 or $370 — is for training in-house for nonretirement purposes.

- Self-development. Whenever businesses that qualify for subsidies give paid time off for educational training, the government has agreed to pay one-fourth of large firms' expenses and one-third of those for small and medium-sized companies. Reimbursement per employee is limited to a maximum of ¥100,000 ($741) per course if the employee is older than age 55 and half that amount if younger. Subsidies to cover wages paid during training to participants is in the same proportion. Workers aged 50 and over who sign up on their own for training after their work day can get up to ¥100,000 ($741) or half the cost of tuition (whichever is smaller). Between ages 45 and 50 workers can get half that amount.

- Skill examinations. Qualifying small and medium-sized companies can receive government assistance of up to one-third the cost of developing skills tests or administering the exams, with a maximum payout per situation of ¥500,000 ($3,700).

- Business diversification. Small and medium-sized enterprises that provide training in connection with the diversification of their operations can receive reimbursement for two-thirds of the expenses involved in training and the same proportion to cover the wages of workers in training.

- Other vocational training purposes. Small and medium-sized firms or their trade associations also can receive assistance under certain circumstances for building vocational training centers or conducting joint, authorized training sessions.

As can be seen from the conditions placed on the grants, Tokyo is emphasizing preparation for a labor market where older workers are more plentiful. Also of concern are the small and midsized businesses that have trouble attracting workers during periods of labor shortage. Promotion of plans to cope with these situations raises questions of whether this approach has enough built-in flexibility to adjust to a variety of labor market conditions.

Tokyo's Approach to Shifting Labor Trends

Policymakers in all countries are befuddled by how much government should help businesses and workers in adjusting to labor market changes and how much should be left to the economists' laws of supply and demand in the marketplace. Japan's experiences in coping show a mix of government interest and market management in addressing, through education and training, the increasing number of service-sector jobs, changing demographics and the internationalization of business. Perhaps fundamentally, the government's role in school-based education has an impact on the labor market, for good or ill.

Expansion of Tertiary Industries and Noncareer Employment - Among the primary considerations as the services sector becomes the major job generator in economically developed countries is whether these jobs will require more or less specialization. Of interest in Japan is how much service-sector companies will focus primarily on keeping a small group of core employees, supplemented by a larger work force of part-time and contract workers. The former group could be expected to receive a high degree of training, particularly if involved in occupations requiring advanced technical skills.[12] Less training might be expected for those involved in part-time work. A shift to contract workers, however, raises questions about who is responsible for training, the company or the prospective employee who might need to present specialist qualifications. Contract workers in Japan do not need to be specialists and, in fact, may be employed in many of the same jobs as regular workers but without the range of benefits — such as company-provided training — associated with career-path employment.

Off-the-job training in the services sector in 1991 ranged from 85 percent participation among finance, insurance and real estate firms to 68.6 percent of the establishments in the transportation and communications industry, with varying numbers of employees receiving training in the companies that offer it. More finance-related firms offered training to all their employees than did any other industry as reported in one 1988 MOL survey (Table 2), but only about 58 percent of all respondents had instituted regularly scheduled training programs and these tended to focus training on fewer, selected employees. One important consideration for the finance, insurance and real estate industries is the small percentage of older workers (see Table 5). As workers age they are more likely to be employed in the narrowly defined services trades. The declining numbers of older workers employed in all but services trades may indicate that other industries push retirement at age 55 or 60 rather than attempting to retrain older workers to meet technological change. Firms may see less reason to invest in training for older workers if the long-term payback is judged too small or the jobs for which they are employed require little training.

A similar rationale holds for part-time workers, the majority of whom are employed in the services sector. Employment figures for 1990 indicate that nonregular workers represented about 11 percent of service-sector staffing. Nonregular employees comprised 13 percent of the employees in wholesale, retail, dining, finance, insurance and real estate establishments. Companies in these industries along with transportation, communications and utility firms provided nearly 82 percent of the nonregular jobs in 1990. These same 1990 figures indicated that women, who make up almost 70 percent of the nonregularly employed, find most of their jobs in the services sector.

A 1991 survey by the Ministry of Labor indicated that of the enterprises surveyed only 21.6 percent of the male part-time employees under the age of 40 and just 19.9 percent of their female counterparts received training. The numbers dropped for both men and women in successive age groups, with only 4.6 percent of male and 2.6 percent of female part-time workers aged 60 and older receiving training. The survey, which classified full-time workers according to management, professional, clerical, service and technical occupations, showed that male technical and professional workers in the youngest age group received the highest share of training, 74.4 percent and 71.6 percent, respectively. For women in that age group the proportion receiving the most training worked in office or clerical jobs, 65.9 percent; the second-highest category was service or sales personnel, 64.5 percent. In successive age brackets the largest percentage of women to receive training never topped 31 percent, the figure for female managers in the 40-49 age group. Most respondents noted that the major reason no training was offered to older female employees was that there were no employees in that category. Management training for men in upper-age brackets predominated over training of other specialists. In the 40-49 age group at least 45 percent of all but male office workers received some form of training.

Table 5: **Employment Distribution of Older Workers in Japan, 1990**

(as share of age group)

	50-54	55-59	60-64	65+
By Company Size				
1,000+ Employees				
Male	31.8%	23.7%	9.7%	6.6%
Female	15.4	13.9	13.2	15.1
100-999				
Male	32.6	32.2	32.9	25.2
Female	33.3	31.6	28.1	21.1
10-99				
Male	35.6	43.2	57.5	68.3
Female	51.3	54.5	58.7	63.9
By Industry				
Manufacturing				
Male	42.4%	37.6%	24.1%	25.8%
Female	46.7	42.0	29.2	25.9
Wholesale and Retail Trade				
Male	13.1	10.8	8.9	10.0
Female	11.9	11.1	9.4	10.0
Finance and Insurance				
Male	3.7	3.5	2.9	1.9
Female	6.7	6.9	10.0	13.2
Services				
Male	12.2	16.0	29.7	34.6
Female	26.6	30.1	40.5	41.2

Source: Ministry of Labor, *Yearbook of Labor Statistics 1990.*

A further implication of the increasing number of services jobs and the likelihood that at least some of these jobs are associated with less training is the potential for employment in the services sector to provide a buffer, targeted for layoffs in the current economic downturn but offsetting the projected shortage of "prime" workers. Recent government policies, in fact, have encouraged the hiring of older workers and women as ways of combating labor shortages. The current slow-growing economy provides indications of how women's jobs often are the first to go. A July report from the Securities Dealers' Association of Japan noted that women held three-fourths of the 16,000 jobs eliminated in the securities industry in a nine-month period ending in March.[13] Another report indicated that several banks are considering hiring female university graduates in clerical positions because they could be employed as well in nonclerical jobs. Clerical positions, however, have less job security than career jobs.

Japan's current economic troubles have resulted in many companies announcing that they would hire fewer university graduates next year and in some cases pare staff. Attempts to consolidate core workers and rely on more part-time and contract workers well might encourage more attention to management training, since managers would be expected to motivate a more diversified group of people.[14] Another result of this consolidation would be to enhance the opportunities for specialists to gain contract work and for Japanese firms to reach out to foreign companies to engage in joint research and development (see *JEI Report* No. 28A, July 17, 1992).

Companies obviously are less interested in providing training for noncore employees. One result of a move to contract labor might be to prompt employees to seek out more training on their own to enhance their employability. The tendency here might be toward specialization, which could be a detraction in hiring, as noted by Messrs. Podgursky and Swaim. Although contract work does not necessarily equate with work performed by specialists, the weakening of a system that encourages conformance to the ideal of career-long employment could free talented workers to change jobs more often. In the year through February 1992 the number of people who changed jobs, whether the most talented or not, reached a postwar high of nearly 2.8 million, up 7.8 percent. A new attitude that does not discourage job changing could motivate employees to obtain more education on their own.

Companies, too, might respond to the current environment by revising their training practices. One reason suspected for corporate Japan's willingness to invest in training is that workers are expected to remain with a company until retirement. Training not only increases an employee's value to the firm but often is used by firms as a motivating factor for promotion, higher pay and prestige. Studies show that companies have made special efforts to retain the most educated employees (with job benefits, such as assistance in housing loans and specially designed pension plans, for example). The current economic climate could encourage even more training of the most valued employees and much less training of other workers.

Another reason for companies to offer their most valued employees specialized training is that studies have indicated that the more specific the job training, the less likely the employee will be able to transfer those skills to another job at a commensurate or better salary.[15] In the past when Japanese firms worried less about a highly valued employee jumping ship the type of training could be general or specific since the employee was likely to stay. As some Japanese firms that sent employees for training at American universities have found, however, general skills are transferable. Business management or engineering skills learned here can be transferred easily if an employee decides to go to work for a U.S. company or to free-lance after returning to Japan. Thus, a concern with job mobility, cited by many labor analysts as one impediment to American companies investing more money in training, may give Japanese companies another reason to concentrate on specific training courses.

Companies on the cutting edge of technological change are among the most likely to entice the highest educated employees with promises of training. One study published by Rand Corp. in 1986 noted that in times of rapid technological change advanced technical training tends to be available primarily within companies rather than from outside sources.[16] The results seem especially relevant to Japan, where corporate R&D efforts outpace those of universities and government-run institutions.

Internationalization - Since large employers in postwar Japan have tried to avoid layoffs, the move to offshore operations would appear to have less of an impact on domestic employment than the parallel move by American companies. When Japanese manufacturers relocate production abroad, they typically retrain workers at home for jobs in new, diversified lines of work. The government extends assistance to companies that offer training because they are undergoing diversification. Moreover, the types of jobs shifted abroad tend to require fewer skills since a lower cost of labor is one reason manufacturers relocate offshore. The remaining, more highly technical jobs most likely would be those requiring continuous updates.

As internationalization relates to Japan's efforts to assume global political responsibilities commensurate with its economic wealth, Tokyo has agreed to encourage more technology transfers, primarily through training of foreign workers sent to Japan (see *JEI Report* No. 7A, February 21, 1992). Multinational corporations offer similar opportunities for employees from their subsidiaries in foreign countries. These training programs enroll only skilled workers, a condition that has not benefited Japanese firms scrambling for unskilled laborers in the dirty, dangerous and disliked occupations rejected by more and more Japanese. The high level of schooling received by most Japanese means they actually may be overeducated for these jobs, which, in itself, raises questions of whether adoption of a more open policy on immigration by unskilled laborers would benefit Japan. Pride in homogeneity is only one of the cultural obstacles to a broader immigration policy (see *JEI Report* No. 23A, June 15, 1990).

Another aspect of internationalization is that Tokyo is encouraging a better standard of living, partly to meet its trading partners' demands for higher domestic consumption. Among the changes in attitudes encouraged under the official government line is for companies to adopt shorter workweeks, which would increase leisure time. Actual implementation of this recommendation, which is not likely in the near term, could result in a greater separation of the goals of the worker and those of the company. If job-hopping increases as a result of such changes and the falling number of labor market entrants, companies might rethink their training strategies in line with studies that show specific company-provided training cuts down the transferability of skills. The premium of a general educational background might impact hiring of those with vocational training under such conditions since the more specifically trained a worker is, the less flexible he or she may be in a rapidly changing business environment.

Education Policies - Criticism of entrance examination "hell" in Japan has focused on the regimentation required of young students and the costs in terms of creativity and well-rounded lifestyles. Although schools there produce highly literate and mathematically capable students who are accustomed to working in teams, not everyone is satisfied that graduates will be adaptable to an information-oriented society that requires varied skills and creative problem-solving approaches. The 1985 National Council on Educational Reform, in fact, urged Japan "... to do away with the uniformity, rigidity, closedness, and lack of internationalism, all of which are deep-rooted defects of our educational system, and to establish ... the principle of putting emphasis on individuality."[17]

Another concern with Japan's educational system as it relates to preparing the next generation of workers is that the emphasis on examinations results in polarizing students onto two tracks: those who move toward college and those who take vocational courses. The selection process is not necessarily based on individual aptitude but on who is more scholastically inclined, according to Nobuo Shimahara of Rutgers University. "Moreover, increasing numbers of students in academic schools are unable to meet the rigid standards because their abilities and aptitudes vary considerably." Mr. Shimahara noted that the frustration arising from the rigidities has led to an increase in school violence and juvenile delinquency.[18] Despite concerns over these problems, the system appears to be working well for corporate Japan. Not only do schools produce a potential employee who is capable of learning new skills on the job, but the educational system weeds out those who do not conform or do not learn quickly, other contributions valued by Japanese businesses.

Unlike American firms and companies in other industrialized countries, Japanese businesses have had less incentive to look into business/school partnerships, the topic of a recent report by the Organization for Economic Cooperation and Development.[19] Many of the reasons that companies in other OECD countries are looking at partnerships with schools stem from a dissatisfaction with their country's respective education systems. This is one more indication that the approach being taken by students, schools, government and companies in Japan is working well from the corporate point of view. Any moves to change the education system in Japan, however, may impact this relationship.

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Tooru Ando provided research assistance.

Notes

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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JAPAN · ECONOMIC · INSTITUTE

JEI REPORT

A Two-Part Report: A and B

NO. 29B
July 31, 1992

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LDP Declares Victory In Upper House Elections

By winning more than half of the 127 seats at stake in the July 26 House of Councillors elections the ruling Liberal Democratic Party partially recovered from the crushing defeat it suffered in the upper house contests three years ago. Party leaders were ebullient that candidates backed by the LDP had captured 69 seats. The ruling party's total in this chamber now is 108 seats, still 19 shy of a controlling majority and six short of the 114 seats held prior to the elections.

The loss of seats apparently mattered less to LDP leaders than the margin of victory. Prior to the upper house contests LDP strategists had maintained that a win of 64 seats or more effectively would set the stage for the ruling party to regain control of the House of Councillors in the 1995 elections (see *JEI Report* No. 28B, July 24, 1992). The party had not fielded enough candidates for that to be a possibility this time. A gain of more than half of the contested seats also represented, according to LDP leaders, the public's endorsement of the controversial United Nations peacekeeping support bill and, in turn, voters' desire to retain the LDP at the helm.

Not all analysts concurred, noting that the electorate's behavior indicated neither readiness for dramatic upheaval nor abundant satisfaction with the LDP's leadership. An historic low voter turnout as well as the surprisingly good performance of a fledgling LDP breakaway party suggest that the Japanese people remain disaffected with ruling party politics and certain policies, these commentators say. With Japan's economy in a slump and the global order in transition, Japanese voters apparently preferred to play it safe and support candidates of the party with the most governing experience. An alternative view is that the opposition parties offered no clear leadership or advantages for backing their candidates. Nor did any one party field enough candidates to gain a majority.

The LDP's 69 seats include 50 won in prefectural district contests and 19 gained under the proportional representation system. In upper house contests Japanese voters cast two ballots: one for an individual representing a particular constituency and one for a political party and its slate of candidates. Each party is awarded seats proportional to the number of votes it receives; no more than 50 seats are filled with candidates from the lists.

Since the ruling party still does not control the upper house, the LDP presumably will have to continue to work with Japan's two centrist parties — Komeito, the second-largest opposition party, and the Democratic Socialist Party, the fourth-largest — to affect enactment of nonmoney legislation. Of the 23 candidates fielded by Komeito, 14 won. Voters chose four of the DSP's 20 nominees. The LDP, Komeito and the DSP now enjoy a combined total of 139 seats in the House of Councillors. This potential coalition would be large enough to overcome any resistance that the Social Democratic Party of Japan, the largest opposition group, might try to orchestrate with other opposition groups and minor parties.

Were it not for the ruling party's willingness to negotiate with Komeito and the DSP, the LDP-led government never would have been able to secure enactment of the precedent-setting legislation that authorizes the overseas dispatch of Japanese military personnel to support U.N.-sponsored peacekeeping operations (see *JEI Report* No. 23B, June 19, 1992). The SDPJ, which throughout Diet debate argued vociferously that the legislation exceeds the limitations of Japan's "peace constitution," tried during the campaign to tap into the Japanese people's still strong pacifist sentiments. Due largely to the Socialists' focus on this issue, many commentators maintained that the peacekeeping support bill — more than Japan's sluggish economy — was the central issue in the elections.

While SDPJ-supported candidates in Hiroshima and Okinawa, two areas that experienced acutely the ravages of World War II, fared well in the July 26 elections, the SDPJ was not as successful in the rest of the country. Only 22 of 43 candidates fielded by the largest opposition party won, less than half the number of positions the SDPJ captured in 1989, but the same number of seats that the SDPJ had up for grabs this time. Therefore, its upper house membership remains at 69. The July 26 contests gave the Japan Communist Party six seats, bringing its upper house tally to 11, or three less than its preelection strength. The tiny United Social Democratic Party, which fielded nine candidates, did not win any seats, leaving just one USDP councillor.

Rengo, the political arm of the Japan Trade Union Confederation and a close ally of the SDPJ, perhaps was the biggest loser; none of the 22 candidates fielded by the party, which had touted itself as "adhesive" for an anti-LDP coalition, was successful (see Table). Some analysts suggested that the reason Rengo fared so poorly is precisely because the opposition parties could not unite on the peacekeeping support bill.

In addition to seeing their victory as an endorsement for the peacekeeping support bill, LDP leaders extended this approval to include backing for a more engaged diplomacy. "We frequently hear ... that Japan always shows up too little, too late when there's a world crisis," former Prime Minister Toshiki Kaifu was quoted as saying. "Now the [Japanese] people agree it is time for us to be more active." If opposition at the grass roots to the peacekeeping support bill had been strong, the LDP would have incurred significant losses, which supports one of the party's contentions. Political observers were less sanguine about reading the election returns as an indication of a more internationalist mood among the electorate or as a ringing endorsement of the LDP. Voter turnout was the lowest in Japan's postwar history, drawing only about 50 percent of the eligible electorate as compared with 65 percent in 1989. A variety of nonpolitical factors may have kept much of the

July 26, 1992 Upper House Election Results

	Prefectural Constituencies		National Constituencies		Total Won	Held Over	Total Strength	
Liberal Democratic Party	50	(51)	19	(24)	69	39	108	(114)
Social Democratic Party of Japan	12	(13)	10	(9)	22	47	69	(69)
Komeito	6	(3)	8	(7)	14	10	24	(20)
Japan Communist Party	2	(4)	4	(5)	6	5	11	(14)
Democratic Socialist Party	1	(2)	2	(3)	4	3	7	(8)
Rengo	0	(1)	–	(0)	0	12	12	(13)
Japan New Party	–	(–)	4	(–)	4	0	4	(–)
Others	6	(1)	2	(2)	8	9	17	(12)

Note: Incumbents in parentheses.

Source: *The Japan Times*, July 28, 1992.

electorate at home — hot, muggy weather plus the start of the summer Olympics, but commentators also suggested that voters simply were not impressed with what they were being offered.

Although three years have passed since the Recruit Co., Ltd. influence-peddling scandal, one factor that contributed to the LDP's defeat in the 1989 upper house elections, the ruling party as recently as February still was plagued by scandals (see *JEI Report* No. 7B, February 21, 1992). It has yet to enact promised legislation that would reform Japan's money-centered political system. The opposition parties, however, remain unable to provide a credible leadership alternative. Some political analysts said the spectacle of politicians from the SDPJ and JCP engaging in a slow-walking type of filibuster to protest Diet action on the peacekeeping support bill did more to tarnish than burnish the Socialists' image as potential leaders. Moreover, unlike in the United States where economic downturns usually hurt incumbent politicians, in Japan when the economy slumps voters tend to be even more wary of political change, commentators have said. "While people say we need a drastic change, in politics and the economy, they reach for stability," Komeito secretary general Yuichi Ichikawa said in an effort to explain a phenomenon that is puzzling for Americans and others who believe discontent requires action.

The surprisingly strong performance by a small party formed only two months ago by Morihiro Hosokawa, a former LDP-backed member of the House of Councillors and ex-governor of Kumamoto prefecture, may support the view that the Japanese electorate, while apparently leery of change, is not completely satisfied with the status quo. Mr. Hosokawa's Japan New Party, which is dedicated to reforming Japanese politics, fielded 16 candidates and won four seats. Prior to the elections many observers had predicted that the fledgling party would not win any seats.

Although the upper house election results satisfied the LDP, not everyone within the ruling party benefited equally. No doubt the outcome fortified the position of Prime Minister Kiichi Miyazawa over the near term and is a relief to the former finance minister, who has been plagued with domestic political problems since entering office in November 1991. However, the politicians that really reaped gains from the recent elections are former Prime Minister Noboru Takeshita and other senior members of the faction that bears his name. The Takeshita faction fielded 34 candidates; 30 won seats. That boosted the faction's strength in the Diet to 108, of which 68 are in the lower house and 40 in the upper house. Mr. Miyazawa's faction, in comparison, put up 11 candidates, of whom seven were elected. This puts the prime minister's group in third place in the LDP factional hierarchy, with 61 lower house representatives and 13 upper house members for a total of 74. The number-two position is occupied by the faction headed by former Minister of Foreign Affairs Hiroshi Mitsuzuka, which has 75 members (58 in the lower house and 17 in the upper house).

Some observers suggested, therefore, that Mr. Miyazawa probably will face increasing pressure from the Takeshita faction to yield the party's top spot and, by extension, the premiership. News reports July 28 of the former prime minister's connection to a scandal involving his faction's alleged ties to an organized crime group through dealings with Tokyo Sagawa Kyubin Co., Ltd. (see *JEI Report* No. 7B, February 21, 1992) may foil any designs, however, that Mr. Takeshita or members of his faction may have on the premiership.

Barbara Wanner

Stock Market Bears Shrug Off Tokyo's Concerns

Alarmed by the continued fall of domestic stock prices just ahead of important national upper house elections, Prime Minister Kiichi Miyazawa and his cabinet tried in late July to break the market's downward slide with a promise of greater fiscal stimulus. Investors ignored not only this pledge but a subsequent discount rate cut, criticizing these moves as tardy and insufficient. This negative reaction has left observers wondering where the stock market's bottom lies now that the government's moves to halt the sell-off have been ignored.

Since hitting a postwar high of 38,915.87 at the end of 1989, the Nikkei average of 225 stocks listed on the Tokyo Stock Exchange has suffered from a weakening economy, stock brokerage scandals and the deflation of the late 1980s' speculative boom. Since dropping through the psychologically important barrier of 20,000 earlier this year (see *JEI Report* No. 11B, March 20, 1992), the Nikkei has been drifting fitfully lower. After falling into the low 15,000s in mid-June, the market staged a rally, rising from 15,741.27 on June 29 to 17,201.73 on July 13. This level proved unsustainable, however, in the face of lower expectations for Japanese corporate profits and heightened concerns about overseas political and economic developments, including tensions between the United Nations and Iraq. The German central bank's decision on July 20 to hike its discount rate to 8.75 percent seemed to dim the outlook for an immediate easing of monetary policy by the Bank of Japan. The Nikkei plummeted by more than 660 points that day, closing at 15,884.48. When the market hit 15,541.95 two days later, Prime Minister Miyazawa decided to act.

With half of the Diet's upper house seats at stake in the July 26 elections, Mr. Miyazawa realized that a plunging stock market could undercut his ruling Liberal Democratic Party's claim as the party of stability and economic growth. The prime minister announced July 23 that he would convene an emergency cabinet meeting the evening of the following day to explore responses to the stock market's woes. Investors had been waiting for some sign of government concern and action. They welcomed Mr. Miyazawa's announcement by pushing the Nikkei up almost 550 points at the close of July 23 trading.

The anticipatory boost was not sustained; the Friday session closed at 15,549.79, as if to say that expectations of supportive government action were low. That estimation proved on target since the Friday evening cabinet meeting produced almost nothing new. The Miyazawa administration reiterated its commitment, made just before the early July summit of the leaders of the world's major industrialized democracies, to pass a large supplemental budget. The cabinet also agreed to initiate legislative action on the budget in September instead of October, as originally envisioned. Beyond this, details about the stimulative package remain hazy; even its total size is undecided. (Speculation puts the extra budget at ¥6 trillion to ¥8 trillion or $44.4 billion to $59.3 billion at ¥135=$1.00.)

The LDP's solid showing in the July 26 upper house elections and the Bank of Japan's July 27 action to shave half a percentage point from its discount rate (see articles in this issue) provided the market with a temporary boost on the first day of the week; the market rose to 15,974.31 in the morning session. It quickly became apparent that there was no real support, however, and the market ended the day at 15,373.34 for a 124.45-point loss. The week provided a new 1992 low (see Graph),

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JAPAN'S YEAR OF ECONOMIC DISCONTENT: WHAT HAS CHANGED?

SUMMARY

During the past year or so American commentators have noticed that the Japanese economy seems to be sputtering uncharacteristically. While Japan's economic growth in 1991 substantially exceeded that of the United States, an increasing number of analysts, particularly in this country, are beginning to ask whether the Japanese economy has undergone fundamental changes that might derail it from extending its 40-year run as one of the world's most robust industrialized economies. Those making this argument cite the remarkable plunge of the Tokyo stock market, which began in early 1990 and continues today, as important evidence for their case.

Many Japanese analysts appear far more sanguine about the prospects for the economy. Although they agree with foreign analysts that countermeasures are required, they differ among themselves as to the appropriate combination of policies. Key to the different approaches is deciding whether the economy's current difficulties foretell a prolonged period of slower growth or, alternatively, whether the current slump is essentially similar to previous postwar downturns in Japan, which have proved modest by industrial country standards. Depending on the answer, the fiscal policy proposals now on the table may be either too little to reignite growth or too large considering the economy's reduced potential growth rate. Whatever balance Tokyo strikes will have to take into account potential economic growth in the 1990s, which no doubt will fall far below the average 5 percent inflation-adjusted rate recorded annually between 1986 and 1991.

Descent from the Stratosphere: An Overview

Some data suggest that the Japanese economy, which recorded the highest rate of inflation-adjusted growth in 1990 and 1991 — 5.2 percent and 4.4 percent, respectively — among major industrialized nations, rather suddenly has become a basket case. That would appear to be one conclusion to be drawn from the remarkable two-year fall of the Nikkei average of 225 stocks on the Tokyo Stock Exchange; by late July it had dropped 60 percent from its all-time peak, with no bottom in sight. While the stock market is critical as a barometer of business sentiment, it does not directly measure business activity. Indicators of current economic conditions, however, are almost as depressing as TSE data.

Those experts making the case that Japan's economy is in a very difficult situation point to such statistics as the monthly index of coincident indicators, an Economic Planning Agency measure designed to show the current state of the economy. The figure for May, the latest month for which data are available, revealed weakness in the economy for the 15th straight month — only one month less than during the 1973-75 downturn, the most severe of the postwar period. By contrast, the measure recorded 16 straight months of economic expansion between January 1987 and April 1988 before experiencing a one-month stall and then reviving in June 1988 to expand in 25 of the 29 months through October 1990. (The index moved inconclusively between November 1990 and February 1991.)

Pessimists regarding the Japanese economy draw many parallels with the U.S. economy, which contracted 1.2 percent in 1991 as measured by real gross domestic product. They note that both nations have many weakened financial institutions, contain a large group of apprehensive consumers and face poor prospects in export markets trying to recover from recession. Some forecasts, typically but not always non-Japanese in origin, have implied an outright decline in Japan's gross national product this year.

Specialists in the Japanese economy, however, generally expect real economic growth of about 2 percent in 1992 and slightly more than that for fiscal 1992, which ends March 31, 1993. Forecasts reflecting December 1991 estimates and revisions through July are shown in Table 1. Even though the estimates have been revised downward in recent months, they still are remarkably optimistic by American standards. A July *Economist* poll of projections from around the world, for example, points to real U.S. and Japanese growth being an identical 2.1 percent in 1992, with the Japanese rate higher in 1993 at 3.4 percent against 3 percent for the United States. In short, despite Japan's present economic difficulties, growth there easily exceeded this country's in 1991 and is projected to match it in 1992 and exceed it again in 1993. If the international forecasters prove correct, the Japanese economy probably also will avoid a U.S.-style recession, defined informally as two consecutive quarters of negative economic growth. The predictions obviously also rule out a full-year decline in economic activity, as occurred in this country in 1991.

Revised Japanese Expectations

If the gloomy outlook of a handful of forecasters regarding the Japanese economy is not likely to be realized, neither are the cheerful expectations advanced by Japanese experts a few months ago. An overwhelming majority of private-sector analysts now strongly reject, for example, the government outlook of 3.5 percent inflation-adjusted growth, a figure adopted last December (see *JEI Report* No. 1B, January 10, 1992). All but one of the business forecasts summarized in Table 1 have been scaled back during the past half year.

However, Table 1 also implies that private-sector projections in Japan, typically for the fiscal year, are considerably higher than the calendar-year predictions made by foreign forecasters. (Organizations such as Nomura Research Institute that develop both calendar- and fiscal-year outlooks do not expect significantly higher figures for the fiscal year.) Inasmuch as at least a few of the private-sector Japanese forecasts should be regarded as deliberately optimistic in order to encourage business, the foreign forecasts on average probably are more on target. However, the latter are not as

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Table 1: **Summary of Forecasts of Japan's Real GNP Growth in 1992**

Fiscal Year Forecasts

	Previous Forecast	Revised Forecast
Government Outlook	3.5%	n.a.
Research Institute on the National Economy	4.0	3.3%
Daiwa Research Institute	3.1	3.0
Nippon Trust Bank, Ltd.	3.2	2.9
Nippon Credit Bank, Ltd.	2.8	2.8
Fuji Bank, Ltd.	3.0	2.7
Sumitomo Life Insurance Co.	3.1	2.7
Kangyo Kakumaru Research Institute	3.1	2.7
Yasuda Trust & Banking Co., Ltd.	2.9	2.7
Bank of Tokyo, Ltd.	3.2	2.7
Mitsui Trust & Banking Co., Ltd.	3.0	2.6
Japan Center for Economic Research	3.2	2.6
Toyo Trust & Banking Co., Ltd.	2.7	2.5
Tokai Bank, Ltd.	2.8	2.5
Yokohama Bank, Ltd.	3.1	2.4
Mitsui Mutual Life Insurance Co.	3.0	2.4
Industrial Bank of Japan, Ltd.	2.7	2.0
Nomura Research Institute	2.3	2.0
Average of Private Forecasts	3.0	2.6

Calendar Year Forecasts

International Monetary Fund	2.2%
Economist Consensus Forecast*	2.1
Nomura Research Institute	1.9
Organization for Economic Cooperation and Development	1.8
Average**	2.0

Note: For projections on a fiscal year basis the previous forecast typically was made in December 1991, while the revised forecast appeared in June or July.

*Average of forecasts of 20 bank and securities companies in Europe, the United States and Japan. Updated monthly.
**Excludes Nomura Research Institute, which is included in the *Economist* consensus forecast.

Sources: *Nihon Keizai Shimbun*, various issues; the organizations listed; and *The Economist*, July 11, 1991, p. 99.

well-known in Japan. This suggests that Japanese businesses have not fully incorporated the most accurate thinking about the likely direction of the economy.

Other evidence also suggests that the Japanese view of the economy reflects an excessive degree of consensus thinking. A poll conducted early this summer of 70 academic and business economists by *Toyo Keizai Tokei Geppo* magazine found that not one expected the Japanese economy to worsen over the remainder of 1992 from the level of early summer.[1] In the United States, where economic opinions are said to outnumber economists, such a convergence of views would be next to impossible. Given the surprisingly weak performance of the Japanese economy to date in 1992 and the inherent uncertainty of economic forecasts, a virtual consensus as expressed in the *Toyo Keizai* poll — even if it turns out to be correct — would not appear to be warranted.

While a percentage point or even a few tenths of a point difference in the forecasts of Japanese and foreign economists may seem like a quibble, the gap carries greater significance if placed in historical perspective. As shown in the Figure, the growth of the Japanese economy has fluctuated since 1970, the first year for which consistent year-to-year Japanese data are available. (In the postwar period prior to 1970 growth rates generally were much higher.) However, even bad years generally have been good ones by international standards. For example, among the Group of Seven industrial nations real growth between 1982 and 1991 averaged 2.8 percent. During that time Japan's performance fell below the 10-year, seven-nation average only in 1986 (a 2.6 percent increase), a recession year by the Japanese yardstick.

The only year since 1970 in which Japan experienced a lower rate of expansion than in 1986 was 1974, when the economy actually shrank by 0.8 percent. Both 1974 and 1986 were exceptional years for the economy in other ways. In the first instance Japan was buffeted by the dramatically higher oil prices resulting from the first oil shock. In 1986 the yen was midway through a dramatic appreciation, in which its value would nearly double against the dollar by late 1988. Both these shocks were perceived at the time as external, although some scholars now believe that the macroeconomic difficulties that occurred in 1974 coincided with the first oil shock and were not caused by it. (For details of this argument, see *JEI Report* No. 33A, August 24, 1990.)

In contrast to the earlier periods of sluggish growth, 1992 shapes up as a year in which the slowdown is unquestionably domestic in origin. While the recession in the United States and elsewhere has not helped the Japanese economy, most analysts — Japanese and foreign alike — attribute the most important role in the downturn to the deliberate deflating of the "bubble" economy, a period between 1987 and 1990 in which asset prices rose at rapid rates and perhaps pushed economic growth rates higher. In the consensus view drastic actions by the Bank of Japan to burst the bubble have led to the slowdown in the rate at which gross national product grows.

If foreign forecasts are correct, Japan's economy will be even weaker in 1992 than in 1986. While avoiding the depths of 1974's drop, it will grow more slowly than in 1975, the second year associated with the first oil shock, or in 1973, the year in which the slowdown began. By contrast, if domestic projections are correct, Japan's real economic growth will be above the rates recorded in either 1974 or 1975 and equal to the 1986 figure. Hence, foreign analysts are saying that Japan's 1991-92 homegrown economic downturn will be worse than that caused by any external disturbance — unless the first oil shock is regarded as the cause of the 1973-75 recession. If domestic economists are correct, they could argue that the economy's worst performances likely have resulted from external developments.

If even foreign analysts prove too optimistic, Japan's economy could be in uncharted waters concerning growth. Most foreign experts willing to hazard a guess about 1993 expect that growth will pick up substantially to 3 percent or more. An increase of less than 3 percent in both 1992 and 1993, however, would be a first for any two-year period since at least 1970. As will be argued below, this scenario appears increasingly likely.

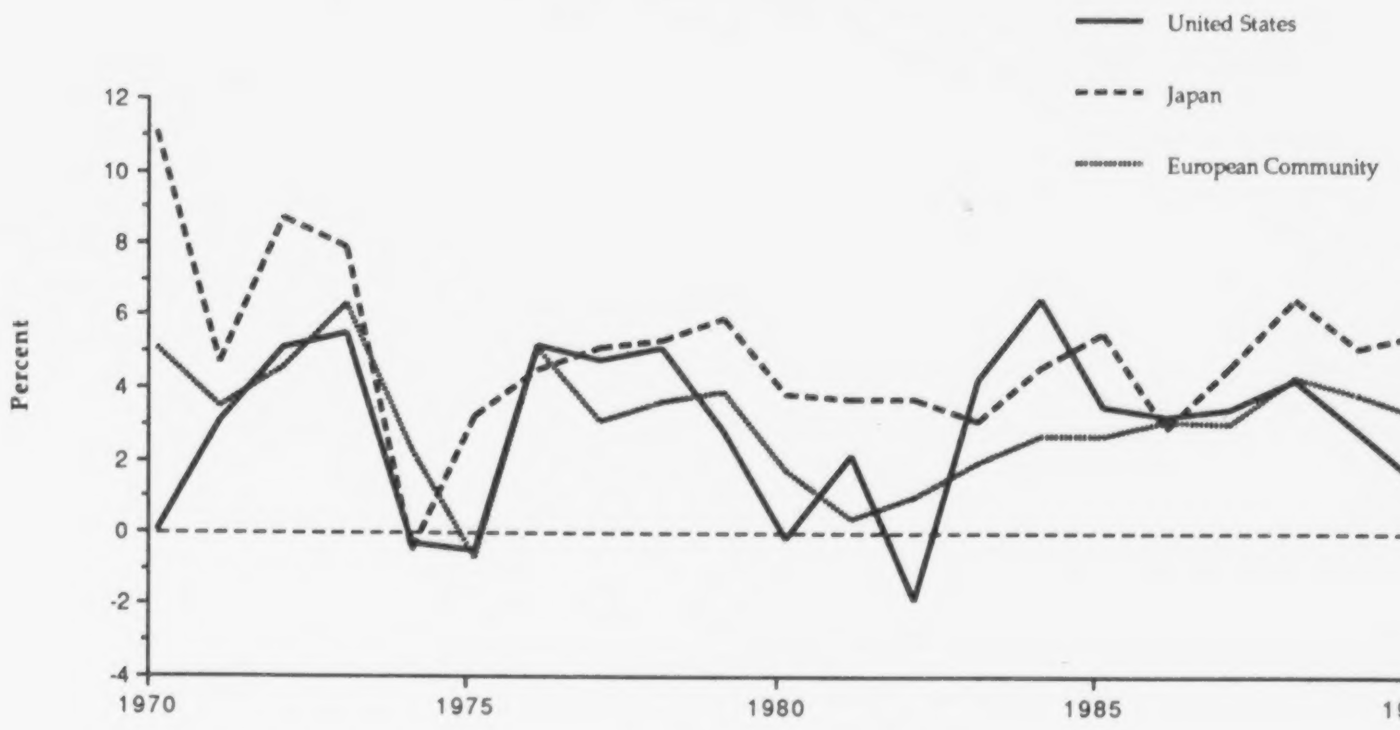
What Caused the Economic Downturn?

Future scenarios depend, in part, on how the economy reached its current state. On this point Japanese economists disagree, with their arguments having a familiar ring to analysts of the U.S. economy.

One group believes that the roots of Japan's downturn are similar to past Japanese slowdowns. Key components in this view are monetary policy and investment behavior. The Bank

International Comparison of Changes in Real GDP, 1970-91

(percent per year)



Source: Economic Planning Agency and Organization for Economic Cooperation and Development of Japan, by all accounts, slammed the brakes on monetary expansion in 1989, especially after Yasushi Mieno became central bank governor in December. Interest rates, which generally had risen throughout 1989, rose yet again in response. As if sensing that the day of reckoning was at hand, the stock market began its prolonged dive in January 1990, within days of Mr. Mieno's assumption of the top BOJ post. Within a few months the growth of the seasonally adjusted money supply had slowed sharply. As measured by M_2+certificates of deposit, the money supply had expanded at double-digit rates on an annual basis between 1987 and 1989; in 1990 it increased 7.4 percent. By the end of 1991 growth had slowed to only around 2 percent annually.

Tighter money and higher interest rates hurt interest rate-sensitive activities beginning in 1989. The largest such category, plant and equipment spending, was little affected initially, though; business investment continued to expand at double-digit rates in 1989 and 1990 before slowing slightly in 1991, when it reached nearly 20 percent of GNP. Analysts who emphasize monetary policy and plant and equipment outlays stress that the rapid rates of increase in such spending in previous years were unsustainable even if interest rates had remained low; by the end of 1991 many firms had more than enough relatively up-to-date capacity. In short, monetary policy combined with the fall in plant and equipment spending from unsustainable figures have reduced aggregate demand this year substantially below the level indicated by a simple extrapolation of past trends.

An especially severe downturn would result if these factors loom particularly large, this group concludes. By midyear M_2+CDs was growing at less than 1 percent on an annual basis, the lowest rate ever recorded. Similarly, plant and equipment investment could have a long way to fall; capital spending in both 1990 and 1991 generated 19.6 percent of nominal GNP, the highest proportion achieved since 1970 when it hit 21.1 percent. Inasmuch as plant and equipment spending between 1976 and 1986 varied between 13.7 percent and 16.1 percent of nominal GNP, simple arithmetic suggests that a 10 percent drop in business investment, a decrease too small to return the ratio to the upper end of the 1976-86 range, would drag GNP down by nearly 2 percentage points, other factors equal.

Plant and equipment spending, moreover, may have benefited from unusually low capital costs during the bubble period, costs that were not fully reflected in overall interest rates. Large firms were able to float bonds with low-interest yields because the securities carried provisions allowing purchases of equity at a later date at what were expected to be favorable prices. Firms took advantage of this window of opportunity to borrow extensively and stock up on new plant and equipment. New issues of warrant and convertible bonds virtually have stopped as a result of the stock market crash, with one result being that plant and equipment spending could drop substantially among the affected firms.

The alternative view of the economy, which echoes many analyses of the American economy, regards Japan's current slowdown as being qualitatively different from previous downturns. The group espousing this view cites the rise and the collapse of asset prices as the main difference. The Nikkei average of 225 stocks more than tripled between 1985 and 1989 before losing more than 60 percent of its value between the last trading day of 1989, when it stood at an all-time high, and late July, when its value approximated that of mid-1986. Unless the stock market stages a rally of unprecedented proportions during the balance of 1992, the Nikkei will have dropped for three straight years, an event not equaled since the market fell for four years in a row between 1961 and 1965. Data on other assets, such as land, are less precise, but land prices currently appear to be off about 30 percent from their 1989 peaks, at least in Tokyo.

The second group contends that the collapse of equity prices and lower land prices have had a devastating effect on the financial sector; that, in turn, has weakened greatly its capacity to serve as a conduit of economic policy. Japan's biggest banks, for example, may constrain their lending to reach international requirements that bank equity represent 8 percent of assets (generally loans) by

March 31, 1993. As the stock market has sunk, reducing the value of securities that banks may count as equity, the tight lending strategy is rendered more probable. In addition, faced with mounting loan losses, financial institutions of all types are likely to be more selective in their credit policies. Finally, to some extent the stock market collapse has discouraged consumer spending as the wealth of stockholding households has fallen.

What Are the Prospective Solutions?

Monetary Policy - Different opinions concerning the source of the problem imply different solutions. Many experts argue that, to the extent that monetary tightness caused the economy's current sluggishness, monetary ease is the solution. Taking a leaf from the prescription book of Milton Friedman, the American Nobel Prize-winning economist, some Japanese analysts believe that the appropriate policy action is to increase substantially the rate at which the money supply grows. For example, if the economy potentially can expand at about 4 percent per year, the money supply could be increased at approximately that rate each year to generate growth without significant inflation, according to this view.

Opponents of this view take their lessons from Mr. Friedman's intellectual adversaries in this country. They note that in Japan, as in the United States, the relationship of the money supply to GNP is unstable, a condition that suggests that this prescription might not work as predicted. Furthermore, the appropriate monetary measure is open to debate, just as it has been in the United States. The rate of growth of the most commonly used measure, M_2+CDs, is influenced heavily by shifts among different types of deposits. In recent months the Bank of Japan has been pushing another, more inclusive measure, broad liquidity, which is less influenced by such shifts. The latter yardstick has shown a more stable growth pattern in recent years; in mid-1992, however, it was growing about 4 percent on an annual basis, a rate less than half that of a year earlier. If broad liquidity accurately reflects the rate of monetary expansion, a case could be made that BOJ needs merely to stay its present course.

Other analysts point out that the upheaval in Japan's financial markets has severed the relationships linking central bank action to bank lending policy and borrowers. Even if BOJ eases up, banks may not want to lend, according to this view. Even if they do make loans available, borrowers may be reluctant to take on additional debt, which would reduce the impact of central bank action. Since the relatively slow growth of both M_2+CDs and broad liquidity has been accompanied by low interest rates, these analysts suggest that the limited demand for borrowed funds is the major factor in reducing money growth and aggregate demand.

To Mr. Friedman's followers the solution would be a boost in the money supply. They might add that BOJ has focused excessively on interest rates as a guide to the rate of monetary expansion. If weak demand for money — rather than the limited growth in supply — is the cause of declining interest rates, then low interest rates give a misleading indication regarding the rate of growth of M_2+CDs or broad liquidity. In short, these analysts argue that BOJ should pay more attention to measures of money and less to interest rates, an argument that some American economists recently have made with respect to Federal Reserve Board policy. Other experts would argue, however, that the combination of low interest rates and sluggish growth of M_2+CDs points to the inappropriateness of monetary policy as a viable option in the current situation.

Fiscal Policy - Fortunately for those seeking another solution, fiscal policy appears a reasonable alternative in Japan. Most prescriptions for the U.S. economy have ruled out expansion-generating spending and tax changes on the grounds that the government budget deficits already are too large. In Japan, by contrast, the government has a budgetary surplus, at least when measured on a broad basis. According to data from the Organization for Economic Cooperation and Development, the overall U.S. budget deficit for all levels of government in 1990, the latest year for which comparable data are available, came to 2.5 percent of GDP. Japan's comparable budget surplus represented 3.1 percent of GNP. (GNP and GDP can be used almost interchangeably in this instance since the two national income concepts are little differentiated within each country.)

Increased government spending or lower taxes would meet real needs in Japan. Even short-term visitors to that nation are struck by the deficiencies in infrastructure, including overcrowded airports and commuter rail systems. Increased government spending could ameliorate some of the crowding. Lower taxes on individuals could promote a shift of national income to households, whose share of GNP has declined in recent years. Fiscal policy is not without its critics, however, particularly among the followers of Mr. Friedman; they regard spending increases and/or tax decreases as being relatively ineffective in expanding the economy and likely to lead to larger government bureaucracies and more pork-barrel projects. In addition, Japanese analysts point out that statistical differences between U.S. and Japanese budget data tend to overstate the apparent contrast in the budget situations in the two countries. Moreover, while the Japanese government recently has run a budget surplus, the accumulated government debt from previous periods of deficit financing still is large.

One effect of increasing government spending and/or reducing taxes is to boost borrowing and the demands on capital markets, thereby raising interest rates. In Japan's case higher interest rates are both good and bad in terms of current policy objectives. They would be good because they would keep Japanese funds at home or attract foreign funds, thereby increasing the demand for yen relative to the supply. The resulting appreciation of the yen would tend over time to reduce Japan's trade surplus, a bone of contention with its trading partners. This argument may well have been behind Washington's advocacy during the 1989-90 Structural Impediments Initiative talks of ¥430 trillion ($3.2 trillion at ¥135=$1.00) in investment by Tokyo in public works during the 1990s, a proposal that became part of the SII agreement (see *JEI Report* No. 26B, July 6, 1990). However, higher interest rates also could crowd out plant and equipment spending, which looms as a particularly large portion of GNP in the Japanese case. Some critics, as suggested above, would counter that capital spending is likely to be depressed regardless. Finally, and perhaps most significantly, higher interest rates could exacerbate the already severe problems facing Japanese financial institutions.

On balance Tokyo appears to have decided that the benefits of fiscal stimulus are worth the costs. In April it announced that FY 1992 spending on public works projects would be accelerated, with approximately 75 percent of the funds planned for the fiscal year to be spent during the first half (see *JEI Report* No. 14B, April 10, 1992). In addition, the government has committed itself to a substantial package to be introduced in the fall in the form of a supplemental budget; other initiatives may be announced later this summer. Although no precise figure has been announced yet, press reports suggest that the supplemental budget could be on the order of ¥7 trillion ($51.9 billion).

The government's 1992 sequence of fiscal policy actions closely follows several previous instances of countercyclical fiscal measures. The timing and the size of those earlier packages appear to have been critical to their effectiveness. For example, in early April 1987 Tokyo announced a speed-up of public works spending and followed up with a substantial supplemental budget that was approved by the Diet in late July (see *JEI Report* No. 15B, April 17, 1987, and No. 29B, July 31, 1987). The result was to avoid a sharp yearend drop-off in public works spending once the effects of the April action to front-load public works spending wore off.

In other instances supplemental budgets have not continued the expansionary effects of a spring acceleration of public works spending. For example, in April 1983 the government announced that public works spending would be front-loaded; that October the Diet passed a stimulus package. After rising sharply in the April-June period, however, public works spending as measured by the GNP statistics declined over the next four quarters despite the October program. In retrospect, the October package, a product of compromise between the Ministry of International Trade and Industry and the Ministry of Finance, appeared to lack much punch.

One lesson of the 1983 and 1987 experiences, the two most recent instances of countercyclical fiscal expansion prior to this year's effort, is that earlier implementation of a stimulus package is more effective than later. A second lesson is that front-loaded public works spending can cause a drag on the economy in the last half of the fiscal year if a supplemental spending package is not ~~big enough~~. Finally, both episodes demonstrate that fiscal changes have a quick impact on the Japanese economy, apparently in contrast to the United States, where changes in government spending affect economic conditions only after a lag of half a year or more.

Potential Pitfalls and Possible Problems for a Japanese Recovery

Boggled Fiscal or Monetary Policy - The 1983 experience is instructive. If the 1992 stimulus package, which at the end of July was still in the formulation stage, gets bogged down in controversy or emerges in a significantly watered-down form, the economy could experience a temporary drag — rather than a stimulus — from public works spending. The opposite risk of an overly aggressive policy is also present. Some analysts believe that the real cause of the drop in 1974 GNP was an excessively expansive monetary policy in the early 1970s, which had produced double-digit inflation by 1973. The expansive monetary policy of that period appeared to have been based on the assumption that the Japanese economy would continue to grow, as it had during the 1960s, at close to 10 percent per year after inflation. Subsequent events proved that assumption incorrect. As late as 1978, however, government officials were reported to believe that 7 percent annual growth was possible, an assumption that also proved unrealistic.

Today analysts are divided as to the long-range growth potential of the Japanese economy. Nomura Research Institute puts the figure at 4 percent annually during the first half of the 1990s and 3.5 percent during the balance of the decade. Various factors suggest that such figures may be too optimistic inasmuch as they do little more than assume the same growth rates that prevailed during the 10-year period ending in 1991, when real growth averaged 4.3 percent. (For details of the factors that could cause a slowdown, see *JEI Report* No. 11A, March 20, 1992.)

Clearly, if monetary or fiscal policies are adopted with the intention of getting Japan on a 4 percent long-term expansion path at a time when a far slower growth rate is the most that could be expected, the stimulus could prove excessive, with substantial price increases resulting. Subsequent policies to stem inflation could give the economy one or more years of suboptimal growth, even if judged from the perspective of a realistically low potential growth rate.

Given the restraining hand of the Ministry of Finance, the risk of attempting too much stimulus in 1992 appears minimal. Worried about the level of outstanding government debt, MOF has shown a historical reluctance to countenance larger budget deficits. Considering its influence, the greater current risk is a repeat of the experience of 1983, when the supplemental budget failed to fill the gap left by the earlier acceleration of public works spending.

Failure of a Large Japanese Financial Institution[2] - Japanese officials are fond of saying that no Japanese bank has failed during the postwar period. While technically true, a handful of financial institutions have been absorbed by one or more healthy institutions when they have been on the verge of failing. (This is exactly the same solution typically adopted by U.S. officials to deal with struggling American banks, savings and loan associations, and credit unions. For a recent example of the Japanese experience, see *JEI Report* No. 18B, May 18, 1992.)

To date, none of Japan's largest commercial banks has needed such a rescue. An increasing number of Japanese experts, particularly in the academic community, worry that such an event could occur, however. If one of Japan's 64 regional commercial banks were to fail, for example, Japan's puny deposit insurance fund easily could be wiped out in a single stroke. Given current resources and the climate of caution among more stable institutions, a rescue might prove impossible. In this situation monetary officials surely would lose their fig leaf concerning Japanese bank failures. Even if a collapse eventually were to be resolved, depositor confidence in Japanese financial institutions could be shaken severely. (Even now, that confidence is not total; reports of shaky loans at some banks have led to widespread deposit withdrawals at the affected institutions.)

A loss of confidence in Japanese financial safety nets, in turn, could affect financial flows, with unpredictable results. No doubt a flight to quality would occur; which institutions or financial instruments would be regarded as secure is not clear. U.S. Treasury securities might look more attractive, for example, because they carry the backing of the U.S. government. However, the Japanese institutions that hold them might appear more risky than before for other reasons, leading to deposit withdrawals and reduced holdings of Treasury securities as the institutions seek liquidity. In this situation inbound capital flows would lead to an appreciation of the yen. Scenarios involving a depreciation of the yen also are imaginable.

If a large bank failure loomed as more than a remote possibility, Bank of Japan and other officials would have far less latitude in developing monetary and fiscal policy responses to the economy's current woes. Fiscal policy measures, for example, would have to be combined with BOJ actions to prevent interest rates from rising. The central bank would be more likely to lower short-term interest rates and risk inflation, if the alternative were bank failures. However, a relatively relaxed monetary policy could prove disastrous to banks in the long run if price increases accelerated, leading to anti-inflation policies that would include extremely high short-term interest rates.

Very Strong Yen - Some of the policies and possible scenarios described above would strengthen the yen. Fiscal stimulation combined with monetary restraint would have this effect, for example. In addition, some analysts have noted that external factors, such as expectations concerning election results in the United States, could drive the yen higher. Inasmuch as the dollar, the yen and other currencies are in the hands of traders who are said to prefer Republican economic policy, the strong prospect of a victory by the Democrat's presidential candidate, Bill Clinton, could send the dollar south before November, implying an appreciation of the Japanese currency. The same currency trends could develop in conjunction with increasing prospects of a victory by Mr. Clinton if traders thought that a Democratic Congress and president would be more likely than divided leadership to reach an agreement to reduce the federal budget deficit; a decreased supply of yen to finance the deficit would increase the value of the Japanese currency.

While not without its benefits, especially in reining in Japan's fast-expanding trade surplus, a higher yen would hurt the profits of Japanese exporters and importers. During the 1985-88 period of yen appreciation many analysts believed that the currency's rising value against the dollar stimulated companies to work harder to reduce costs and improve their products as well as to accept lower profit margins in foreign markets. Indeed, exporters reported that their so-called break-even points, as measured by the yen-dollar exchange rate, improved dramatically; companies that had considered themselves uncompetitive at ¥140=$1.00 found that they could be profitable even at ¥125=$1.00. (For details of this argument, see *JEI Report* No. 4A, January 27, 1989.) Profits for exporters, although sometimes dipping in the early stages of the yen's appreciation, had reached high levels again by 1988. Firms, however, had many winds at their backs in this apparently stunning improvement. Foreign economies as well as the Japanese economy continued to grow; by 1987 Japan was booming. Hence, fixed corporate costs could be covered more easily from domestic revenues, allowing firms to reduce margins in foreign markets and still show higher profits.

In short, profitable operations above break-even points depend not only on costs and product quality but also on demand conditions at home and abroad. This argument was brought home earlier this year when the few companies still willing to talk about break-even points admitted a deterioration; one firm, which previously said it was profitable at ¥120=$1.00, now needed at least ¥130 to the dollar. If the yen were to reach ¥100=$1.00 within the next 12 months — a not altogether unlikely possibility given its current value of around ¥125 — and if the economies of Japan and its main trading partners were to remain weak — another less-than-remote possibility, Japanese corporate profits could plummet in the export and import sectors. These businesses already are reporting profits nowhere near the stratospheric levels that prevailed in FY 1990.

Failure of a Large Nonfinancial Concern - In an extreme case a large exporting firm or a company that competes with imports could fail if the yen reached a sufficiently high level and stayed there. Weak home demand or financial overextension could produce a similar result. While Japanese firms are declaring bankruptcy in 1992 at a rate of more than 12,000 per year, all such concerns in recent years have been either relatively small companies, nonmanufacturing firms or both.

During previous downturns even some large manufacturers had severe troubles. In some cases they appear to have been saved by their *keiretsu* links. In the best-known instance of this development Sumitomo *keiretsu* companies helped Mazda Motor Corp. out of severe financial difficulties in 1979.[3] However, *keiretsu* ties have become noticeably looser in recent years, as manufacturers have declared their financial independence and developed closer links with companies outside their own group. Mazda, for example, has developed numerous significant financial and product linkages with Ford Motor Co., although it still maintains close ties to Sumitomo companies as well.

Whether *keiretsu* companies would welcome prodigal sons back into the fold should severe financial problems develop is problematic. If not, Tokyo could be forced to develop countermeasures quickly or permit foundering companies to fail. While the skills of Japanese bureaucrats are legendary, developing a consensus on what policy to adopt could take more time than would be available. If a large Japanese manufacturer ended up failing, many assumptions that prevail in both Japan and abroad concerning the inexorable strength of major manufacturing firms would be shattered. Workers, whose perceived job security would decline dramatically, surely would change their behavior in their role as consumers and in bargaining on wages. The event's greatest significance, however, would be as a symbol of the severity of the economic downturn.

Dramatic Drop in Consumer Spending - Such a failure of a nonfinancial firm has to be regarded as remote. One consequence — a drop in consumer sentiment — is somewhat less so, especially considering the likelihood that the full extent of Japan's economic slowdown has not yet been appreciated. Any number of unwelcome events could reduce consumer spending below the levels normally expected during a slump. For example, nonfinancial firms facing business problems could abandon their current policy of hoarding workers for the not-so-distant day when a robust economy confronts a shrinking labor market. A prolonged recession, of course, would make hoarding workers less of an imperative and more of a cost, even for healthy companies. If so, many workers who have felt secure in Japan's still-tight labor market would feel much less so — even if layoffs remain very limited -- because of corporate efforts to limit wage increases and other means. The increasingly important, if seldom exercised option, of going to work elsewhere would be a less viable alternative for employees of large companies. In short, a somewhat less tight labor market would be felt even by employees whose own jobs are secure, implying that workers in their role as consumers might cut back expenditures. Many analysts, including Yutaka Kosai, head of the prestigious Japan Center for Economic Research, worry that consumers have reduced their spending as a proportion of disposable income already, lowering the chance that households will play their expected role in leading Japan to an economic recovery.

Welcome Surprises

Not many of these potential pitfalls are likely in themselves. Indeed, the Japanese economy may avoid all of them during the next few years. However, they should be regarded as risks with a nontrivial chance of occurring. Generally, the possibilities discussed so far would increase the probability that real growth in Japan could drop into the 2 percent range or lower and stay there for more than a year; none seem to carry the possibility of a surprise in the opposite direction. Since few analysts expect a major bank failure, for example, the lack of one would not be a surprise.

Most likely to be welcomed is a surprise involving improved foreign economies. Few economists expect the U.S. economy to boom over the next 18 months, for example, but one cannot be sure. A strong dollar would be another unexpected favorable development for the Japanese economy. If the American currency were to rise as a result of demands for funds to finance an exploding U.S. federal budget deficit, the yen would depreciate and Japanese exporters would benefit. In addition, Japan's Asian trading partners are likely to continue to grow relatively rapidly. Even if the economies of the United States and Europe stagnate, these nations could provide a significant boost to Japanese exports.

One favorable factor would be surprising to American — but not Japanese — analysts. Market signals in Japan appear to work better as macroeconomic stabilizers than they do in other industrial nations. If anything, financial liberalization and deregulation may have enhanced the ability of market forces to respond to weakness in one sector by allocating resources to another. Seventy years ago economists believed that such factors allowed economies to trend toward full-employment; the worldwide Great Depression reduced the ranks of such true believers dramatically. Given Japan's outstanding ability to avoid severe unemployment and U.S.-style recessions in the postwar period, however, factors such as real wage and price flexibility may be effective to some degree in maintaining a high level of aggregate output. Japanese analysts who regularly predict that consumer spending, for example, will pick up the slack left by stagnant exports or weak investment spending seem to be betting that market forces will save the day.

Finally, business investment — whose fluctuations threaten to destabilize the economy — also could buoy it, especially in the long run. Even if plant and equipment spending drops substantially, for example, the stock of such capital will continue to grow. In the 12-month period ending March 31, 1992 the capital stock grew an inflation-adjusted 7.5 percent before depreciation. Even a generous allowance for depreciation implies that the productive capacity of the Japanese economy rose substantially. If plant and equipment spending remains at approximately FY 1991's level in coming years, the capital stock will continue to grow at almost the same rate in the future. A combination of growing demand, higher real labor costs, or increased capital productivity could justify such an expansion. This argument suggests that, if either macroeconomic policy measures or market forces can be marshaled to mobilize this capital to produce output, the Japanese economy could regain its strong growth performance. The next 18 months or so may provide an interesting test of this hypothesis.

Conclusion

Even if allowance is made for such special Japanese factors, the trends now underway suggest that the economic slowdown in Japan is unusually severe — even if that message has not shown up yet in the country's still strong yearly and quarterly GNP figures (see Table 2). In 1991 real GNP grew 4.4 percent against a rise in industrial output of 2.1 percent. Even though GNP was 2.1 percent higher on a price-adjusted preliminary basis in the January-March 1992 quarter than a year earlier, industrial output was down 4.7 percent. In April, May and June industrial output was 6.1 percent, 8.8 percent and 4.2 percent lower, respectively, than in the same three months of 1991. (The June figure is preliminary.) Barring a miraculous turnaround, industrial output is likely to fall for 1992 as a whole for only the fourth time since the index was introduced in 1964.

A comparison of GNP data, which cover all sectors, and industrial output statistics, which emphasize manufacturing, suggests that the nonmanufacturing sector has been far stronger in the last 18 months or so than manufacturing. While this difference may reflect a shift in resources toward nonmanufacturing, past evidence indicates that nonmanufacturing industries can serve only a limited role as buffers for shocks to the manufacturing sector. Industrial output fell 5.1 percent in 1974, 11

Table 2: **Japan's Real Gross National Product at Constant (1985) Prices**

(in billions of yen, seasonally adjusted, quarterly totals and rates of growth at annual rates)

	FY 1990	FY 1991	April-June 1991	July-September 1991	October-December 1991	January-March 1992
Gross Domestic Product	¥406,615.1	¥420,648.2	¥418,446.7	¥420,211.8	¥420,104.1	¥423,649.6
	(5.7%)	(3.5%)	(4.0%)	(1.7%)	(-0.1%)	(3.4%)
Gross National Product	409,214.5	423,565.4	421,003.9	423,052.8	422,715.7	427,193.3
	(5.5%)	(3.5%)	(2.8%)	(2.0%)	(-0.3%)	(4.3%)
Personal Consumption Spending	234,085.0	240,619.7	238,652.2	240,449.8	240,692.7	242,690.2
	(4.0%)	(2.8%)	(6.5%)	(3.0%)	(0.4%)	(3.4%)
Private Residential Construction	22,848.6	20,261.2	21,110.7	20,620.8	19,621.3	19,603.6
	(4.9%)	(-11.3%)	(-23.6%)	(-9.0%)	(-18.0%)	(-0.4%)
Private Fixed Nonresidential Investment	88,990.7	91,683.0	91,559.7	92,225.3	91,491.3	91,440.7
	(12.1%)	(3.0%)	(-3.0%)	(2.9%)	(-3.1%)	(-0.2%)
Change in Business Inventories	2,901.4	3,214.6	3,172.3	3,420.9	3,075.5	3,218.1
	(-20.8%)	(10.8%)	(13.7%)	(35.2%)	(-34.7%)	(19.9%)
Government Current Expenditures	34,428.7	35,428.7	35,595.7	35,114.8	35,297.1	35,691.5
	(2.4%)	(2.9%)	(6.5%)	(-5.3%)	(2.1%)	(4.5%)
Government Fixed Investment	26,095.1	27,579.7	27,378.4	27,392.6	27,655.8	27,826.1
	(4.4%)	(5.7%)	(20.3%)	(0.2%)	(3.9%)	(2.5%)
Change in Government Inventories	95.1	-197.4	-199.8	240.8	-942.6	91.8
	(*)	(*)	(*)	(*)	(*)	(*)
Net External Sector	-230.1	4,975.9	3,734.7	3,587.8	5,824.6	6,631.3
	(*)	(*)	(*)	(*)	(*)	(*)
Exports of Goods and Services and Factor Income Received	73,760.4	77,175.7	74,796.4	76,671.6	77,949.8	79,214.6
	(7.7%)	(4.6%)	(-8.7%)	(10.4%)	(6.8%)	(6.7%)
Imports of Goods and Services and Factor Income Paid	73,990.6	72,199.8	71,061.7	73,083.8	72,125.2	72,583.3
	(7.2%)	(-2.4%)	(-7.9%)	(11.9%)	(-5.1%)	(2.6%)

*Cannot be calculated or meaningless.

Source: Economic Planning Agency

percent in 1975 and 0.2 percent in 1986. As noted earlier, 1974 and 1986 were the two years in which overall economic growth was the slowest. The simple, if far from exact, relationship of industrial output to GNP growth in the past points to subnormal aggregate growth at least for 1992. The fact that preliminary data showed that inventories still were growing in June suggests that production cutbacks probably have not run their course and easily could continue well into 1993.

These arguments imply that the Japanese economy will be lucky to expand in the widely forecast 2 percent range this year and may not grow much faster next year. Furthermore, the potential exists for severe shocks that could reduce real growth still further; the upside potential appears minimal. As noted earlier, even if no major hitches develop, the Japanese consumer is likely to be surprised at the rough ride. American analysts may well conclude, though, that the Japanese economy has ridden out yet another violent storm while barely getting wet.

For further information, contact **Douglas Ostrom.**

Tooru Ando and Mark Wu provided research assistance.

Notes

[1] "Ekonomisto Shichijunin-ni Kikimashita," *Toyo Keizai Tokkei Geppo,* August 1992, pp. 12-15.

[2] I am indebted to Thomas F. Cargill of the University of Nevada at Reno for this example.

[3] For details of the Mazda rescue, see Richard Pascale and Thomas Rohlen, "The Mazda Turnaround," *Journal of Japanese Studies,* Summer 1983, pp. 219-263. For information about *keiretsu* generally, see *JEI Report* No. 2A, January 12, 1990.

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JAPANESE POLITICS: ON THE BRINK OF CHANGE OR STUCK IN NEUTRAL?

SUMMARY

Ever since the ruling Liberal Democratic Party suffered a stunning upset in the 1989 House of Councillors elections political commentators have argued that Japan is on the threshold of a new political era in which the LDP no longer would be the perennial party in power. This argument has persisted despite sound victories by the ruling party in the 1990 elections for the more powerful House of Representatives — an outcome that ensured the continuation of a LDP-led government — and more recently in late July's upper house contests when LDP-backed candidates won over half of the 127 seats at stake. In the view of these analysts grass roots disaffection with the LDP's leadership is growing and that, in turn, will precipitate a shake-up in the ruling party-dominated political system.

Change does not appear to be an obvious choice of the electorate, however. Those backing the arguments for change note that voter apathy and a widespread perception that the Japanese people are powerless to influence the "business of politics" were significant factors in the latest election. Various political observers also point out that the opposition parties, either individually or as a coalition, have yet to offer voters a credible leadership alternative. Opinion polls over the past several years have shown a readiness for new leadership as many Japanese have indicated their dissatisfaction with a one party-dominated political system. Election results since 1989, therefore, should be read more as a vote of no-confidence for the political opposition than as a ringing endorsement of LDP rule, these analysts say.

While conditions appear ripe for a skake-up, opinions are mixed as to when or how a transition in Japanese politics will happen. Few observers expect the political opposition to coalesce to mount an effective challenge to the LDP in the lower house contests anticipated for early next year. Some political analysts have speculated that a small LDP breakaway party may precipitate movement or that the ruling party may splinter. Such changes, however, will not happen without action by Japanese voters, whose current indifferent mood may keep the party system stuck in neutral.

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LDP's Upper House Wins Mask Discontent

When 69 of the 82 candidates backed by the Liberal Democratic Party won in July's House of Councillors elections, the ruling party declared victory and partial vindication for its humiliating defeat in the 1989 upper house contests. The ruling party's total in this chamber now stands at 108, still 19 shy of a controlling majority and six short of the 114 seats held prior to the elections. Nevertheless, LDP strategists had maintained before the July contests that a win of 64 seats or more of the 127 at stake would represent the public's endorsement of the ruling party's leadership and, in turn, set the stage for the LDP to regain control of the House of Councillors in the 1995 elections (see *JEI Report* No. 28B, July 24, 1992).

The ruling party has held a majority in the more powerful lower house since 1955, and that has ensured 37 uninterrupted years of Liberal Democratic Party prime ministers. Since the opposition parties wrested control of the upper house from the LDP three years ago, however, the ruling party has found it necessary to work with Japan's two centrist parties — Komeito, the second-largest opposition party, and the Democratic Socialist Party, the fourth-largest — to gain passage of nonmoney legislation. As was apparent by the protracted nature of the LDP's dealings with Komeito and the DSP to secure enactment this year of a bill authorizing the overseas dispatch of Self-Defense Forces for United Nations-sponsored peacekeeping operations, coalition-building has proved difficult and has not lent itself to expeditious policymaking (see *JEI Report* No. 23B, June 19, 1992). Thus, by giving the LDP a solid win in the late July upper house contests, ruling party strategists contend that voters, in effect, have indicated that they want the ruling party to reclaim control of the upper chamber and reinstitute the stable, one party-dominated political system under which Japan has prospered.

Most Japanese political observers, however, dismiss this interpretation of the ruling party's performance in the late July elections. When considering the number of seats now held, for example, the LDP's victory is not so impressive. As mentioned, the ruling party still is six seats shy of its preelection strength in the House of Councillors and a whopping 36 seats below its standing before the 1989 trouncing. The Social Democratic Party of Japan, the largest opposition group, did not perform as impressively as it did three years before, but neither did it completely fall down. Of the 43 candidates fielded, 22 won; this was the same number of seats that the SDPJ had up for grabs. The performances of the other major opposition parties were mixed. Notably, the Japan New Party in its first outing and other minor parties garnered an impressive 22 percent of the popular vote in nationwide constituencies (see Tables 1 and 2).

This is hardly a resounding endorsement of the LDP-dominated political system. The reasons cited for this outcome vary, but the ruling party's inaction on some of the key factors that led to its downfall in the House of Councillors elections three years ago no doubt has fueled grass roots disenchantment with the LDP. Specifically, the ruling party vowed in 1989 to tighten campaign financing laws and reform Japan's multiseat system in the lower house as a means of getting at the fundamental causes of the Recruit Co., Ltd. influence-peddling scandal. That affair, which embroiled senior LDP members and forced the resignations of then Finance Minister and now Prime Minister Kiichi Miyazawa and then Prime Minister Noboru Takeshita, was a key issue in the LDP's 1989 upper house debacle. In the intervening period, however, the LDP-led government has been unable to pass any political reform initiative. Similarly, the 3 percent consumption tax against which voters also cast retaliatory votes in the 1989 upper house contests remains in place, although subsequent revisions have eased the burden on some taxpayers.

Some commentators say that the July elections for the House of Councillors more accurately reflected a lack of credible leadership alternatives. The Japanese people are not entirely satisfied with

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Table 1: **July 26, 1992 Upper House Election Results**

	Prefectural Constituencies		National Constituencies		Total Won	Held Over	Total Strength	
Liberal Democratic Party	50	(51)	19	(24)	69	39	108	(114)
Social Democratic Party of Japan	12	(13)	10	(9)	22	47	69	(69)
Komeito	6	(3)	8	(7)	14	10	24	(20)
Japan Communist Party	2	(4)	4	(5)	6	5	11	(14)
Democratic Socialist Party	1	(2)	2	(3)	4	3	7	(8)
Rengo	0	(1)	--	(0)	0	12	12	(13)
Japan New Party	--	(--)	4	(--)	4	0	4	(--)
Others	6	(1)	2	(2)	8	9	17	(12)

Note: Preelection status in parentheses

Source: *The Japan Times*, July 28, 1992.

Table 2: **Popular Vote in July 26, 1992 Upper House Elections**

	Prefectural Constituencies			National Constituencies		
	Votes	Share		Votes	Share	
Liberal Democratic Party	19,711,045	43.43%	(30.70%)	14,961,199	33.29%	(27.32%)
Social Democratic Party of Japan	5,846,238	12.88	(26.38)	7,981,726	17.76	(35.05)
Japan Communist Party	4,817,001	10.61	(8.81)	3,532,956	7.86	(7.04)
Rengo	4,399,684	9.69	(6.82)	0	0.00	(0.00)
Komeito	3,550,060	7.82	(5.10)	6,415,503	14.27	(10.86)
Democratic Socialist Party	1,039,979	2.29	(3.63)	2,255,423	5.02	(4.85)
Others	6,019,180	13.27	(18.57)	9,801,890	21.78	(14.88)
Total	45,383,187	99.99	(100.00)	44,948,697	99.98	(100.00)

Note: 1989 election results in parentheses

Source: *The Japan Times*, July 28, 1992.

the ruling party, but neither are they confident that the opposition parties can manage the economic and foreign policy challenges confronting Japan in the post-Cold War era. These sentiments also were apparent in the February 1990 lower house elections; voters at that time gave the LDP the margin of victory it needed to maintain a majority in this chamber but also expanded the SDPJ's roster in the lower house as "checking votes" against the ruling party (see *JEI Report* No. 12A, March 23, 1990).

Japanese political affairs expert Gerald Curtis of Columbia University sees both the 1990 and the 1992 national elections as votes of "nonconfidence in the governing abilities of the political opposition." Given the LDP's fragile support base, aggregate election results do not reflect the extent of public dissatisfaction with the ruling party or the desire for political change, Mr. Curtis contends.[1] In February and March of this year the electorate snubbed the ruling party in two consecutive upper house by-elections in Nara prefecture and Miyagi prefecture, respectively, in reaction to revelations that a former close associate of Prime Minister Miyazawa was arrested on bribery charges and that LDP politicians allegedly received money from a company with ties to organized crime (see *JEI Report* No. 7B, February 21, 1992). But when it came time to select their upper house representatives in late

July, Japanese voters did not lash out at the LDP as harshly as they did in the Nara and Miyagi contests or in the 1989 House of Councillors elections.

Japanese political observers offer the following explanations for why the ruling party appeared to fare as well as it did in the most recent nationwide elections:

Voter Apathy - Political observers contend that Japanese voters in recent years have become increasingly indifferent and cynical about their country's politics. In the July elections, in particular, a record low 50.7 percent of Japan's estimated 94 million eligible voters bothered to cast ballots; the rest evidently preferred the comfort of their homes on a Sunday and the distraction of televised Olympic Games to hot, muggy high school gymnasiums and the other uncomfortable venues where voting usually takes place. Granted, since the upper house does not have the lower house's authority to elect prime ministers, ratify treaties and pass money bills, voter turnout for House of Councillors contests usually is 5 to 10 percentage points less than for House of Representatives elections. Even so, Akira Kurihara, a political sociologist from Rikkyo University, maintains that the average Japanese has become unusually ambivalent about Japanese politics. The Japanese are resigned that "no matter what they do, politics won't change," Mr. Kurihara says.[2]

Mr. Curtis concurs that the electorate generally is fed up with the ruling party's clubby, "smoky backroom" politics. He points out as significant the 20 percent-plus of the popular vote that went to the Japan New Party and other minor parties. Mr. Curtis contends that 70 percent of the Japanese voting public is displeased with the choices they are being offered. This calculation is derived from the 50 percent of the voters who stayed home and the 20 percent who cast "protest" votes for candidates from parties with names and raisons d'etre that range from the Japan New Party and the Welfare and Taxpayers' Party on one end of the spectrum to the Unidentified Flying Object Party and Vinegar-Loving Party on the other end.

In upper house contests Japanese voters cast two ballots: one for an individual representing a prefectural constituency and one for a political party and its slate of candidates. In the nationwide races each party is awarded seats proportional to the number of votes it receives; no more than 50 seats are filled with candidates from these lists. Because of the tremendous expenses associated with fielding individual candidates in prefectural contests, minor parties trying to get a toehold in the upper house usually run a slate of candidates for the so-called proportional seats.

Although voters are dissatisfied with the LDP-dominated status quo, they are not worried enough to deny government leadership to the ruling party. The average Japanese does not perceive the scandals involving the LDP, the peacekeeping support bill and even the sluggish economy as directly affecting their daily lives and wonders why he or she should bother to instigate a political upheaval, Mr. Curtis contends.[3] Virtually all commentators agree that, "warts and all," the Liberal Democrats still are viewed by voters as the only politicians competent enough to lead the country; thus, even when turnout is low, the LDP usually receives the greatest share of votes.

Opposition Party Pitfalls - The opposition parties once again in the latest vote failed to project a credible leadership image. Following the SDPJ's unprecedented gains in the 1989 upper house elections, the Socialist-led opposition had an opportunity to exercise greater influence in the policymaking process and, in turn, demonstrate that it possessed a coherent "vision" of Japanese domestic and foreign policies. The SDPJ's inability in the 1990 lower house contests to match its victory seven months before suggested to the Japanese people that the political opposition was unable to rise to this challenge (see *JEI Report* No. 48A, December 21, 1990). Even in preparing for the 1992 upper house races, the opposition parties appeared unable to learn from past experiences. The poor electoral strategy, lack of well-conceived policy alternatives, ideological differences and inter- and intra-party divisiveness that were the political opposition's undoing in the 1990 lower house elections also were apparent during the more recent upper house races.

Particularly illustrative of the SDPJ-led opposition's tendency to rely on reactive strategies rather than attempting to seek compromise was its handling of the U.N. peacekeeping support bill. During Diet debate on the legislation the Socialists argued vociferously that the dispatch of SDF personnel to provide even nonmilitary support to U.N. peacekeeping operations would constitute a blatant violation of Japan's "peace constitution." Public opinion polls that showed as many as 53 percent of the respondents against the legislation seemed to buttress this approach, but other polls indicated that the Japanese people backed the bill as a means of demonstrating the country's willingness to assume greater responsibility for global political developments. In light of these differing attitudes the SDPJ, the Japan Communist Party and other opponents remained committed to their principles but then employed a variety of obstructionist tactics to block enactment.

Members of the Socialist-led opposition had no compunctions about rushing the podium (in effect, physically threatening the chairman) during committee deliberations and voting. An even more dramatic demonstration of opposition party members' willingness to resort to extreme actions was the SDPJ's orchestration of an "ox-walk." This walking filibuster, in which participants file into the chamber one-by-one and walk excruciatingly slowly to the ballot box to cast their votes, dragged out the final upper house vote on the U.N. peacekeeping support bill for more than three days. Moreover, this strategy ultimately was ineffective in undermining support for the legislation in the Diet and back in members' districts.

The Socialists then made enactment of the peacekeeping support bill the central issue of the July upper house elections in the hope of tapping still strong pacifist sentiments at the grass roots and cutting into the LDP's support base. Political observers contend, however, that the SDPJ's emphasis on the peacekeeping support bill and particularly its filibuster strategy ultimately backfired. Televised coverage of the "ox walk" made opponents appear silly — and, thus, ill-equipped to govern — rather than passionately committed to a position.

Differences within the political opposition on the peacekeeping support bill also hurt the SDPJ and others at the polls. As mentioned, the SDPJ, the JCP and the tiny United Social Democratic Party allied to oppose the bill; Komeito and the DSP joined forces with the LDP to enact the measure. The lack of a unified opposition undermined the Socialist-led effort to discredit the ruling party's policy. The divided opposition front particularly hurt Rengo, the political arm of the Japan Trade Union Confederation, which had touted itself as "adhesive" for an anti-LDP coalition. None of the 22 candidates fielded by the party in the late July contests was successful.

State of the Economy - Some analysts have proposed that the electorate's apparent unwillingness to hand the LDP a major setback in the July contests as well as other elections is related to the state of the Japanese economy. The most popular theory — which has appeared so often in the media that many pundits now offer it as conventional wisdom — holds that Japanese voters tend to stick with the LDP when the economy is not faring well. One proponent of this view appears to be Komeito secretary general Yuichi Ichikawa, who was quoted after the July elections as saying that the Japanese people "reach for stability" in politics and the economy, even though they may say the country needs drastic changes.[4]

A recent report, however, suggested that the correlation between economic conditions and voting behavior resembles the U.S. pattern; that is to say, recessions usually hurt incumbents of the president's party. Reseachers for Nippon Credit Bank, Ltd. considered the election results for the previous nine House of Councillors elections (1965-89) and, using short-term manufacturing surveys as an indicator of the general economic outlook, concluded that when satisfaction with economic conditions declined, so did votes for the LDP. When Japan faced international economic crises, however, ruling party candidates tended to benefit. Political scandals also interfered with the correlation between economic conditions and voting behavior, the Nippon Credit report said.[5]

Yoshiaki Kobayashi, a Keio University professor, challenged the bank study and offered yet another explanation for how and why LDP candidates may be affected by the economy's ups and downs. "The [Nippon Credit] report ignores a critical difference in the voting pattern between rural and urban areas," Mr. Kobayashi argued. "When the economy is bad, people in rural districts increase their support for the ruling LDP ... because they expect more public works to be provided to stimulate the local economy and they think only the LDP can do that."[6]

Table 3, which uses Economic Planning Agency statistics to determine the overall state of the economy, generally appears to give credence to the theory that LDP candidates benefit during economic downturns when they are up for election in the lower house. When considering upper house elections, however, this theory does not hold up as well in the 1974-92 period and completely breaks down in earlier years.

Table 3: **Relationship between State of Economy and LDP's Electoral Performance**

Lower House Elections			**Upper House Elections**		
Year	State of Economy	Seats Won/Lost	Year	State of Economy	Seats Won/Lost
1960	Expansion	+9	1959	Expansion	+10
1963	Expansion	-13	1962	Recession	-2
1967	Expansion	-6	1965	Recession	+2
1969	Expansion	+11	1968	Expansion	-2
1972	Expansion	-17	1971	Recession	-7
1976	Expansion	-14	1974	Recession	0
1979	Expansion	-9	1977	Recession	+1
1980	Recession	+38	1980	Recession	+6
1983	Expansion	-36	1983	Expansion	-1
1986	Recession	+50	1986	Recession	+4
1990	Expansion	-14	1989	Expansion	-36
			1992	Recession (unofficial)	+33

Note: Recessions and expansions as defined by the Economic Planning Agency based on industrial output and other indicators under a procedure that results in more recessions than would occur under the American notion of recession, which typically is defined as two consecutive quarters of negative growth in the gross national product.

Sources: Economic Planning Agency and, for upper and lower house election results, Ministry of Home Affairs and Gerald L. Curtis, *The Japanese Way of Politics* (New York, New York: Columbia University Press, 1988), appendix.

Some analysts conclude from this data that it is hard to document a link between the economy and voter support for the ruling party. The numbers can be manipulated to support whatever one wishes, they say. In fact, some members of the business community contend that general economic conditions have absolutely no impact on the voting behavior of the average Japanese. A specific economic policy, such as a tax on businesses or individuals, can provoke an anti-LDP response. When voters went to the polls three years ago to select their upper house representatives the 3 percent consumption tax certainly fanned the fires of discontent. However, projections that the Japanese economy will grow by far less in 1992 than the 3.5 percent forecast by Tokyo's economic planners (see *JEI Report* No. 30A, August 7, 1992) did not appear to incite an anti-LDP revolt in the recent elections. Voter apathy and lack of confidence in the political opposition were the salient factors that affected the outcome at the polls, these businessmen say.

Forces for Change Rumble Beneath the Surface

The Japanese people at the moment still appear unwilling — or simply do not care — to rock the boat skippered by the LDP for nearly 40 years. Dissatisfaction with the political system is as much evident as is disenchantment with the ruling party. While the LDP could help engineer an overhaul of the system, after so many years in power ruling party politicians have too much vested in the current arrangement. Japanese political experts contend, however, that transformation forces are at work beneath the surface that, if properly tapped, could result in a major reconfiguration of the current political party structure. The question for which no one seems to have the answer is exactly what event would trigger a public outcry for major systemic change.

Kent Calder, an expert on Japanese politics at Princeton University, suggests that traditional business support for the LDP may be waning. The dominance of that conservative party is becoming less important for big business than it was during the high-growth period of the 1960s and 1970s, Mr. Calder contends. Because industry finds itself less reliant on debt, the need to avoid change in the political environment is less acute. Moreover, with the increasing multinationalization of Japanese companies LDP-style pork-barrel politics no longer effectively serve the interests of the business mainstream.[7] Mr. Calder adds that changing demographics and quality of life issues also will create pressures for political change. "The Japanese electorate is more urban, more fluid and more critical ... and more internationally conscious than that of the past," he says. "It is an electorate that is more volatile, and that manifests less one-party loyalty than was true until the late 1970s."

Columbia University's Mr. Curtis suspects that the growing sense of social inequality in Japan could be the powder keg provoking a restructuring of the political system.[8] Much of the postwar Japanese social order and the nation's political stability have been built on the pervasive public belief that Japanese society is relatively fair to all and that the government would act to foster social equality, Mr. Curtis explains. The government no longer may be able to provide this equality, however. In recent years, for example, Tokyo has come under pressure from Washington to gradually strip away the societal "equalizer" provided by subsidies and market protection for Japanese farmers. Thus, when Tokyo in 1988 agreed to liberalize imports of beef and oranges this action came to symbolize for Japanese farmers the "readiness of the LDP to sacrifice their interests to protect big manufacturing industries from U.S. protectionist measures," Mr. Curtis suggests, noting that the subsequent retaliation surfaced in the 1989 upper house elections.

In addition, the Columbia University scholar says that the "settling down" of Japanese society has begun to create new class distinctions and "distortions in the institutions and policies that originally were adopted to foster equality." Only students from upper middle-class and well-educated families earn entrance to prestigious Tokyo University, for example, and the progeny of successful businessmen and politicians often are handed the leadership reins in both business and government rather than working their ways through the ranks. Adding to the growing perception of an elite class, Japan's so-called bubble economy, driven by stock market and real estate speculation, produced a new group of "super rich," Mr. Curtis notes.

The common thread angering voters in the 1989 upper house elections was that the Recruit affair, which involved bribery as well as insider trading, plus the consumption tax and agricultural liberalization sorely offended the public's sense of what is just, fair and equitable about Japanese society, according to Mr. Curtis and others (see *JEI Report* No. 32A, August 18, 1989). If anything, these inequalities have worsened in the intervening three years. Judging by voters' choices in the 1990 lower house elections and the recent upper house elections, however, the Japanese people still appear worried that by fully venting their frustrations with the political status quo they will disrupt the prosperity that many of them have come to take for granted. Too, since the opposition parties do not present a more attractive alternative, the restive electorate has no one to turn to in revolt. Scared of testing the mettle of an untried alternative leader, the Japanese people apparently prefer to tread water for the time being.

Political Realignment: All Talk, No Action ... for Now

In the weeks leading up to the July upper house contests numerous articles and editorials appearing in both the Japanese and the English-language press speculated that these elections could open the door to reconfiguration of the political opposition and even, perhaps, of the LDP. Some analysts predicted a split between the SDPJ's right and left wings and the formation of a new center-left party, comprised of the Socialists' right wing and one of the centrist parties. There also has been speculation that the ruling party is poised to splinter, with some factions aligning themselves with one of the centrist parties or the right wing of the SDPJ. These analysts couched their predictions on the results of recent opinion polls that showed nearly 60 percent of the respondents favored the formation of a coalition government incorporating the LDP and at least one of the opposition groups.[9]

The Japan New Party, which fielded 16 candidates in the July elections and captured four seats, has attracted considerable attention as one possible instigator of political change. Although the number of seats captured by the fledgling group is small, the two-month-old party staged a stronger showing than any other newly established party since the upper house's proportional representation system was introduced in 1983. Many commentators attributed the party's surprisingly strong debut to voter disaffection and a desire for change. Even Shin Kanemaru, deputy prime minister and one of the most influential figures in the LDP, reportedly remarked that the breakaway party may develop into a driving force for change.

The Japan New Party founder, Morihiro Hosokawa, a former LDP upper house member and ex-governor of Kumamoto prefecture, contends that the established parties are incapable of reforming the political system and coping with fast-changing political and economic developments both at home and abroad. A completely new party is needed to lead Japan into the future, Mr. Hosokawa contends. The Japan New Party seeks to eliminate the current government bureaucracy, which the former Kumamoto governor feels is too centralized and inefficient. Instead, the party would delegate authority to local governments for everything but defense and diplomacy.

Other political observers offer a less glowing appraisal of the JNP's performance in the upper house elections and are not optimistic that the party will develop into the catalyst for reform that Mr. Hosokawa thinks it will. Mr. Curtis, who believes that conditions are ripe for a major assault on the LDP, does not regard the JNP's four-seat win as effectively tapping voter restiveness. Nathanial Thayer of Johns Hopkins School of Advanced International Studies agrees that it is too soon to declare that the system is beginning to experience a shake-up. The proof of the new party's popularity and alleged potential for transformation will come with next year's lower house elections, for which Mr. Hosokawa's group will have to run considerably more than 16 candidates if it wants to pose a threat to the LDP or otherwise disrupt the established order.

Messrs. Curtis, Thayer and other analysts also discount predictions of a split in the Socialist camp or a splintering of the LDP. Rumors of a formal separation of the moderate and the liberal wings of the SDPJ have been rampant for some time. After the Socialists failed to effectively exploit their 1989 victory, these rumors intensified. History has shown, however, that the SDPJ has tended to become paralyzed, rather than mobilized, by divisions within its ranks (see *JEI Report* No. 48A, December 21, 1990).

A coalition that includes all elements of the political opposition also is unlikely. For the past three years the political opposition has held numerous conferences, summits of party heads and other brainstorming sessions in a vain attempt to forge a unified front. Personalities and ideological differences repeatedly have interfered with this process. The strong disagreements that were aired between and among the opposition groups concerning the peacekeeping support bill virtually has snuffed any interest in an anti-LDP opposition front in the near future.

Kazuo Aichi, a former director general of the Environment Agency and a member of the LDP's Takeshita faction, recently was quoted as saying that one of the reasons that his faction pulled out the stops to expand its membership in the July upper house elections was so it could play a leading role in any future party realignment.[10] Other reports contend that Ichiro Ozawa, a former LDP secretary general and a leading player in the Takeshita faction, is pushing for the formation of a party comprised of the Takeshita group and Komeito.[11]

In the wake of the July elections, however, most analysts are skeptical that an opposition party/LDP coalition or realignment will occur, despite what public opinion polls indicate or what these politicians have told the press. Mr. Curtis notes that for at least the past decade polls have shown that the Japanese public would prefer an arrangement that allows the opposition parties to participate with the LDP in governing the country. But this has not occurred and will not occur, he says, because the public has not forced the ruling party to change.

Moreover, the current political arrangement offers virtually no incentive for a major LDP faction to relinquish actual or potential control of the government for the purpose of forming a new party regardless of poll indications that such a move would be good for the country.[12] Most postmortem commentaries on the recent upper house elections contained the same theme: given the opposition parties' majority in the House of Councillors, the ruling party's best bet for the foreseeable future is to keep the door open to further cooperation on an issue-by-issue basis with Komeito and the DSP to ensure passage of nonmoney bills.

Outlook: What Would It Take To Trigger Change?

Most analysts contend that the July upper house contests confirmed that the current LDP-dominated political system will remain intact for the foreseeable future. However, the nature of voter behavior in these elections — the low turnout and the relative success of minor party candidates — suggests an increasing dissatisfaction with the political status quo. What has emerged is a Catch-22 situation. People are discontented, but since there are no attractive leadership alternatives they grudgingly stick with what is familiar and that, in turn, breeds even more dissatisfaction. Japanese political observers contend that conditions are so ripe for a major overhaul of the party system that, given the right trigger, a dramatic upheaval could occur at any time. Without a catalyst, however, change could be a long time in coming.[13]

The question is: What would provoke the electorate to demand major changes in Japanese politics and policymaking? Another major scandal in which senior ruling party politicians received huge sums of money might push voters over the edge, particularly if the LDP-led government is not perceived as having addressed effectively its promise to improve the average Japanese person's living standards. In this regard, rumors have been circulating that one senior LDP member and one opposition party official may be arrested in the near future in connection with a scandal that surfaced earlier this year involving Tokyo Sagawa Kyubin Co., Ltd.'s alleged ties to organized crime groups (see *JEI Report* No. 7B, February 21, 1992). Insiders do not believe, however, that this particular affair will be serious enough to upend the LDP or shake up the current party structure.

It is unclear to what extent the general state of the economy really influences voter behavior. But the Japanese people might demand a systemic overhaul if the economic policies pursued by the current or future LDP-led governments are viewed as burdening certain segments of the population over others and/or have begun to seriously undermine Japanese industrial competitiveness.

Another possible trigger may come in the foreign policy area. If the electorate feels that the ruling party is pushing Japan to shoulder international political responsibilities in a manner that appears to fly in the face of the principles on which the country's postwar foreign affairs have been conducted, the Japanese people may propel one of the pacifist-leaning opposition groups (the SDPJ, for example) into a leadership position. This only would be possible, however, if the Socialists, on their own or in concert with other opposition groups, were to develop a comprehensive, well-conceived vision for Japan's foreign as well as its domestic policies.

Some combination of all three developments might provoke an outcry at the polls even more dramatic than occurred in the 1989 upper house elections. Analysts emphasize, however, that it is up to the Japanese people to indicate unequivocally their desire for change. Political parties on their own tend to suffer from inertia.

For further information, contact **Barbara Wanner**.

Mark Wu provided research assistance.

Notes

[1] Telephone interview with Gerald L. Curtis, Columbia University, New York, New York, August 4, 1992.

[2] Jocelyn Ford, "Voter Apathy Keeps Campaign Cool," Kyodo News Service, July 22, 1992.

[3] Curtis, *op. cit.*

[4] David Sanger, "Ruling Party Wins In Japan Vote But Victory Is Diluted By Apathy," *The New York Times*, July 27, 1992.

[5] Cited in Nathaniel B. Thayer, *Japan's July 26, 1992 Elections: What To Look For* (Washington, D.C.: Johns Hopkins School of Advanced International Studies, 1992), p. 9.

[6] Shu Watanabe, "Executives Are Mixed In Backing LDP," *The Japan Times*, July 17, 1992, p. 3.

[7] Kent E. Calder, *Japan's Changing Political and Economic System: Implications for Japan's Global Role,* paper prepared for the Georgetown University-Japan Economic Institute Conference on Japan's Future Global Role, Washington, D.C., March 11-14, 1992, pp. 5-7.

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JAPAN ECONOMIC INSTITUTE

JEI

REPORT

A Two-Part Report: A and B

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Cautious Responses Greet Conclusion Of North American Trade Pact Talks

After 14 months of meetings negotiators from the United States, Canada and Mexico heralded on August 12 the conclusion of talks to link more closely the three economies. The North American Free Trade Agreement worked out by the countries eventually will eliminate all tariffs on industrial and agricultural goods produced by the participants, help safeguard intellectual property rights and remove most barriers to investment in the region. For observers in Japan and other countries, however, concerns remain over whether the free trade arrangement will limit North American trade and investment opportunities for nonparticipants.

Soon after the talks were concluded representatives of the three NAFTA governments set to work on specifics for implementing the pact. Many political and business leaders in North America and outside the region said they would withhold judgment on the agreement until such details are available for examination. Meanwhile, U.S. industry advisory groups are expected to prepare reports for Congress on how the agreement will affect American interests. The reports and the draft text of the agreement will be sent to Capitol Hill in early September, after lawmakers have returned from the August recess. At that point Congress will have 90 calendar days to consider the pact and the trade law changes necessary for implementing it. Once the agreement is signed and implementing legislation is submitted, Congress must vote up or down on the bill within 90 session days.

Many American business leaders welcomed the agreement, apparently concurring with President Bush that "by sweeping aside barriers and expanding trade" NAFTA will make U.S. companies more competitive internationally. Throughout the negotiations, however, a number of

Other industries in Japan similarly have been apprehensive about NAFTA rules of origin. In a report released this June an advisory committee to the Ministry of International Trade and Industry said that the regional content requirements anticipated under NAFTA for color television sets and semiconductors as well as motor vehicles would discriminate against nonsignatories and violate the General Agreement on Tariffs and Trade. Other observers point out that the TV sets turned out by Japanese electronics firms' assembly plants in Mexico already have nearly 60 percent local content. Japanese interests also have been awaiting the outcome of the negotiations covering the financial services sector. NAFTA provisions aimed at opening Mexico's long-closed financial services market are expected to offer new opportunities there for overseas companies as well as firms based in North America.

The Japanese government has taken a cautious stance toward the new free trade arrangement. A statement from the Ministry of Foreign Affairs said that Japan "in principle" welcomes the conclusion of the negotiations. But the statement also underscored Tokyo's position that NAFTA must "strengthen the international free trade system, be fully consistent with the GATT and other international rules as well as with bilateral arrangements, and not raise barriers to third countries, including Japan, in the North American market."

The statement urged NAFTA participants to provide a full explanation of the accord so the Japanese government can evaluate the contents and the implications of the pact. Tokyo's position on NAFTA will be decided only after a careful examination of the agreement, according to the statement. Moreover, Japanese government officials have reiterated their intention of ensuring that NAFTA is consistent with international trade rules; Tokyo will push for a detailed GATT committee review of the pact. The statement also indicated that Japan would like a say in the implementation of the North American trade pact, a role addressed this spring by the Japan-Mexico Commission for the 21st Century (see *JEI Report* No. 21B, June 5, 1992). The official response further stated that Japan "would like to engage in active discussions with countries having a common interest, at the GATT and elsewhere, on the formation of the NAFTA and its impact on the global trade and economy, as well as its effects on the non-NAFTA countries, especially those of the Asia-Pacific region." The Foreign Ministry reportedly has sent a letter expressing Japan's concerns about the proposed trade arrangement to U.S. Trade Representative Carla Hills.

Indicative of the concerns of many of Japan's East Asian neighbors about the impact of NAFTA on their economies was a report released earlier this summer by the Pacific Economic Cooperation Council. PECC cautioned that the North American arrangement "could divert trade and investment from Pacific economies." The Korea Foreign Trade Association recently voiced another common worry in the region in suggesting that exports — for example, South Korea's — will be displaced by products manufactured in Mexico. Singapore, however, has backed NAFTA under the conditions that the arrangement does not create a protectionist trade bloc and adheres to international trade rules. Some observers worry that East Asian economies will push for their own regional trade bloc to counter NAFTA. To date, however, representatives of most governments in the region have argued against closed trade arrangements and have moved toward closer economic cooperation with some caution (see *JEI Report* No. 5B, February 7, 1992).

Margo Grimm

Japan's Balance of Payments Surplus Jumps

A recent Japanese cartoon shows a very sick patient labeled the Japanese economy. In the midst of surgery the doctor, apparently Prime Minister Kiichi Miyazawa, has gone on summer vacation, which leads to an angry reaction on the part of the patient. In fact, Mr. Miyazawa is hard at work seeking a hoped-for cure in the form of an economic stimulus package. The current account statistics for the second quarter, released August 5, point to symptoms of what ails the economy. In the April-June period Japan's surplus by this comprehensive measure of trade rose 53.2 percent from a year earlier (see Table 1).

Table 1: **Japan's Balance of Payments**

(in millions of dollars)

		Trade Balance	Exports (f.o.b.)	Imports (f.o.b.)	Services (net)	Current Account Balance	Long-Term Capital (net)
1987		$96,386	$224,605	$128,219	$-5,702	$87,015	$-136,532
1988		95,012	259,765	164,753	-11,263	79,631	-130,930
1989		76,917	269,570	192,653	-15,526	57,157	-89,246
1990		63,528	280,374	216,846	-22,292	35,761	-43,586
1991		103,044	306,557	203,513	-17,660	72,901	37,057
1989:	I	21,311	66,945	45,634	-3,595	16,064	-5,612
	II	19,794	66,560	46,766	-4,892	14,283	-30,801
	III	19,770	68,157	48,387	-4,023	14,957	-21,559
	IV	16,042	67,908	51,866	-3,016	11,853	-31,274
1990:	I	14,393	65,460	51,067	-701	12,305	-16,086
	II	13,614	65,510	51,896	-5,279	7,892	-18,985
	III	17,149	70,500	53,351	-8,045	7,400	-7,247
	IV	18,372	78,904	60,532	-8,267	8,164	-1,268
1991:	I	20,729	74,978	54,249	-920	10,260	10,707
	II	23,352	71,990	48,638	-4,064	18,664	-7,103
	III	27,745	76,934	49,189	-6,735	19,604	30,843
	IV	31,218	82,655	51,437	-5,941	24,373	2,610
1992:	I	31,368	80,425	49,057	-2,646	27,581	13,406
	II (p)	31,516	78,704	47,188	-2,147	28,599	-12,756

One of the sick patient hypotheses widely believed in the United States gets little support from the numbers. According to this argument, as an economy weakens, imports are likely to fall and exports rise as exporters shift to overseas markets to compensate for sluggish demand at home. The figures for exports and imports shown in the table appear consistent with this argument, but they are misleading. The appreciation of the yen and other price movements over the past year mask the fact that the volume of imports rose more than that of exports, a distortion also observed in the customs-clearance trade statistics released earlier. (For details of this argument, see *JEI Report* No. 28B, July 24, 1992.)

The figures for tourism — included in Table 1 as part of services — are almost as unhelpful for diagnosis. Experts sometimes argue that foreign travel is particularly sensitive to the level of consumer confidence since it represents an easily postponed luxury. If this argument were correct, Japanese consumers would appear to be an optimistic lot; they spent $6.3 billion overseas in the April-June period, 15.7 percent more than a year earlier and a record for the second quarter. A hint of softness in the travel market is apparent, however, if one compares the 1992 figures with those of 1990 on the grounds that the 1991 data reflected lingering reluctance to travel abroad in the wake of the Persian Gulf War. The latest travel expenditures are only 5.9 percent higher than two years ago despite a 19.2 percent appreciation of the yen since the same quarter of 1990. In other words, Japanese overseas travel in the spring declined in real terms compared to the same season two years ago.

Further perusal of the current account statistics would reveal to Mr. Miyazawa something he already knows — that the most apparent weakness in the economy is in capital spending and the financial sector. Japanese firms are even more reluctant to invest overseas in new plant and equipment than they are at home. Direct investment abroad plummeted to just $2.7 billion in the April-June quarter, a 67 percent drop from a year earlier and the lowest quarterly total since the same period in 1986. By contrast, domestic capital spending has been virtually flat in recent quarters. Japanese investors were almost as unenthusiastic about investing in overseas securities, such as stocks and bonds. Compared to a year earlier, they purchased far fewer bonds and became net sellers of equities this past spring. The increase in bond purchases from the anemic level recorded in the first quarter presumably reflected widening yield differentials in favor of foreign bonds (see Table 2).

Table 2: **Japan's Net International Long-Term Securities Transactions**

(in millions of dollars)

		Net Japanese Purchases			Net Foreign Purchases			Net
		Bonds	Stocks	Other*	Bonds	Stocks	Other**	Outflow
1987		$-72,885	$-16,874	$2,002	$6,675	$-42,835	$30,079	$-93,838
1988		-85,812	-2,993	1,856	-21,628	6,810	35,116	-66,651
1989		-94,083	-17,887	-1,208	2,400	6,998	75,746	-28,034
1990		-28,961	-6,256	-4,464	16,991	-13,276	30,938	-5,028
1991		-68,202	-3,630	-2,474	21,241	46,779	47,264	40,978
1989:	I	-14,003	104	577	-1,646	9,004	16,212	10,248
	II	-25,091	-6,108	-776	-587	-6,196	27,501	-11,257
	III	-25,871	-4,795	722	5,403	757	14,123	-9,661
	IV	-29,118	-7,088	-1,731	-770	3,433	17,910	-17,364
1990:	I	-869	-4,946	717	6,182	-11,713	8,246	-2,383
	II	-9,353	-2,153	-954	4,975	838	723	-5,924
	III	-10,905	-459	-2,405	4,790	-3,380	10,485	-1,874
	IV	-7,834	1,302	-1,822	1,044	979	11,484	5,153
1991:	I	-13,356	463	-1,348	1,418	17,486	9,129	13,792
	II	-22,423	-2,840	-1,353	6,348	4,140	11,778	-4,350
	III	-11,120	-134	-94	9,508	15,245	13,317	26,722
	IV	-21,303	-1,119	321	3,967	9,908	13,040	4,814
1992:	I	-4,021	3,975	-1,057	3,540	7,479	3,061	12,977
	II (p)	-14,074	417	1,943	-4,055	256	1,965	-13,548

*Yen-denominated bonds issued in Japan.

**Bonds issued outside of Japan by Japanese institutions.

Note: For outflows a minus sign indicates an increase in assets abroad. For inflows a positive value indicates an increase in Japanese liabilities to foreigners.

Foreign investors, for their part, weighed in with their own resounding voice of no confidence regarding the Japanese economy. Net equity purchases, which had buoyed the weak stock market for months, declined to a mere $0.3 billion, the smallest figure since the fourth quarter of 1990. (This wariness appeared warranted. On August 18 the Nikkei average of 225 stocks listed on the Tokyo Stock Exchange hit its lowest level since early 1986.) Low interest rates in Japan compared to those available abroad presumably explain foreigners' mammoth $4.1 billion sell-off of Japanese bonds during the second quarter. The change in bond purchase patterns by both Japanese and foreign investors was the biggest single factor in swinging the quarterly flow of securities purchases back to a net outflow for the first time in nine months. Similarly, the overall long-term capital account showed funds flowing overseas again on a quarterly basis after nine months of net inflows.

In short, the April-June current account statistics offer little conclusive evidence that trade in goods and services reflects weak economic conditions in Japan. Direct investment and portfolio data, however, suggest uneasiness on the part of both Japanese and foreign investors. Mr. Miyazawa's counterparts in Washington and elsewhere appear less worried about curing the patient, the Japanese economy, than relieving one of the alleged symptoms, the current account surplus. A widely anticipated economic package involving substantial government spending would treat both the patient and the symptom. Increased spending by Tokyo would boost domestic demand, for example. In addition, by bidding up market interest rates as a result of increased borrowing, the package could increase the demand for yen and raise the value of the Japanese currency, thereby making Japanese exports less competitive and imports more so. (This effect on foreign trade probably would be smaller if the Bank of Japan took measures to offset the rise in interest rates.) In time, the current account surplus would contract, other factors equal. While both the symptoms and the illness could linger for months, a stimulus package eventually could turn out to be just what the doctor ordered.

Douglas Ostrom

Tokyo Plans Emperor's Trip To China

September 29 marks the 20th anniversary of the normalization of Sino-Japan relations, and both Beijing and Tokyo would like to capitalize on the occasion to cement friendly ties. For the commemorative events Beijing has been keenly interested in the great symbolic value that would be represented by a visit by Emperor Akihito. Hotly debated by Japanese politicians behind the scenes, an imperial visit now appears likely to take place this fall. Controversies, however, continue to stir passions on both sides of the Sea of Japan regarding what remarks the emperor will make on his trip.

The development of improved relations with China looms large in Tokyo's vision of its expanded global role. While its democratic allies harshly condemned the crushing by Chinese troops of June 1989 prodemocracy student demonstrations in Tiananmen Square, Tokyo strove not to isolate Beijing by maintaining low-level diplomatic and commercial channels. Although Beijing has not softened significantly its human rights policies since Tiananmen Square, Tokyo argues that its efforts have forestalled even harsher treatment of demonstrators and encouraged Beijing's cooperation on such issues as the United Nations resolutions condemning Iraq during the Persian Gulf crisis and the U.N.-negotiated settlement of the Cambodian civil war.

This open-door policy has kept bilateral trade mainly on the upswing. After declining by 24.1 percent in yen terms in 1990 when Tiananmen Square sanctions were observed at various levels, Japanese exports to China posted a 30.9 percent gain to just under ¥1.2 trillion the following year. The expansion has continued through the first six months of this year, with exports up 32.5 percent to ¥671.7 billion. Imports from China have enjoyed steady growth, rising 12.7 percent in 1990 to ¥1.7 trillion, 10.6 percent in 1991 to ¥1.9 trillion and 13.5 percent during the first half of this year to ¥985.9 billion. In dollar terms, based on Ministry of Finance trade-weighted exchange rates, Japan shipped over $6.1 billion worth of goods to China in 1990 (off 28 percent from the year before). Exports rebounded 40.2 percent in 1991 to nearly $8.6 billion and are up 39.2 percent to $5.2 billion this year for the January-June period. Dollar-based imports, according to MOF calculations, hit $12.1 billion (up 8.1 percent) in 1990, $14.2 billion (up 17.9 percent) in 1991 and $7.6 billion (an 18.9 percent hike) for the first half of 1992. The fact that Japan has run a trade deficit with China in recent years has proved to be more of a political asset than a source of friction in bilateral relations.

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REPORT

A Two-Part Report: A and B

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ARE U.S. WEAPONS PRODUCERS DEPENDENT ON JAPANESE AND OTHER FOREIGN SUPPLIERS?

SUMMARY

The increasing globalization of the American economy, the diffusion of technological capabilities and the Pentagon's declining budget have focused attention on the U.S. defense industry's vulnerability to foreign suppliers. The distinction between dependency and vulnerability develops when the loss of a foreign source would have a serious negative effect on national security. For most foreign-supplied items vulnerability is only a remote possibility because of the existence of alternative sources. Nevertheless, the use of foreign inputs in military equipment is increasing to the levels seen in commercial production, particularly in the lower tiers of the industry's supply chain and mainly for the economic reasons of cost and quality. Japanese firms and products do not dominate foreign defense supplies except for some electronics components and optical items.

The fear of politically motivated cutoffs or other kinds of inaccessibility to needed parts and advanced technologies, especially from Japan, has stimulated several studies of the problem. Adopting policies to increase and disperse the number of sources is usually the best approach to dealing with potential vulnerabilities. Stockpiles can be used when the supply is concentrated in a single firm or country. Other policies include defense of supply lines, pressures to counter political cutoffs, substitution of alternative materials or components and the redesign of systems. The benefits from foreign sources of supply include lower costs, higher quality, speedier delivery and more advanced technologies than might be available from American sources. The policy problem is to balance the benefits of dependency against the risks of vulnerability and to mitigate the risks through policies that minimize the costs of insuring against uncertain future events.

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The Globalization of Supply

As far back as 1790 Congress showed concern about the new republic's dependence on foreign suppliers for manufactured goods, particularly "for military and other essential supplies."[1] Responding to a request on this matter from Congress, Secretary of the Treasury Alexander Hamilton in 1791 proposed policies to stimulate the broad development of manufactures. (Indeed, Mr. Hamilton gave little consideration to military supplies in his arguments for the importance of manufacturing but rather used the "national security" rationale provided by Congress to promulgate a broader policy.) Despite the early concern, the United States was to remain in a dependent position for much of its military technology until 1945.

At the end of World War II the United States for the first time became preeminent in military process and product technologies. Yet, at the same time, when American leaders helped to initiate new policies aimed at developing and integrating the world economy, they planted the seeds for the very globalization that eventually would undermine U.S. defense autarky. Since 1945 the United States gradually has become a more active participant in the global economic system. Imports, which were only 6.1 percent of gross national product as recently as 1960, now account for 11 percent of the national product. In manufacturing the foreign share is greater; nonpetroleum merchandise imports make up 20 percent of the "goods" sector of GNP. Despite the historical desire for defense industrial independence, the growing globalization of U.S. economic activity has had an inevitable effect on American weapons autarky. Defense planners gradually have come to sense a level of dependence and vulnerability to foreign suppliers not experienced since the 1930s.

The perception of vulnerability to foreign companies and nations has been abetted by several other recent trends: international economic development, falling defense budgets and the loss of U.S. dominance of many defense technologies. Worldwide economic development has been accompanied by a general diffusion of technical competence and industrial expertise. Specialized producers of hundreds of products now can be found in a score of countries in Europe, Asia and elsewhere. War planning, which had accommodated the geographic concentration of familiar materials like chromium or tungsten, now must focus on less familiar minerals, materials and products in less familiar places.

Since most foreign products are chosen for reasons of economic efficiency, the military in the past could buy itself out of dependency by simply paying higher prices for U.S.-made products. Declining U.S. defense budgets, however, are placing a greater premium today on reducing costs just at the time that a greater variety of high-quality, low-cost foreign supplies are becoming more available.

Electronics, computing, communications and new engineering materials are examples of technologies in which the military occupied the frontiers between the 1940s and the 1980s. Recently, however, that dominance has been lost as commercial demands not only have surpassed the defense market in size but also have called for higher levels of performance. The arcane technologies and black arts of weapons production now are becoming banalized. As commercial research and development and production of high-end products have arisen abroad, sourcing of military components often has been shifted to these new suppliers.

In short, the peculiar period of U.S. independence in defense technological and industrial affairs prevailing since 1945 is drawing to a close. Closely tied to this loss of independence has been the rise of Japan as a leading exporter to the United States and a key source of many defense electronics components. Japanese technical competence is demonstrated by, among other things, the scale and the quality of Japanese corporate patents in the United States. From 1985 to 1989 Japanese

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companies were granted as many as two-thirds the number of U.S. patents as American companies. One could dismiss these figures as simply reflecting the well-known Japanese propensity to patent every possible finding; however, the average quality of these patents as measured by examiner citations is higher than comparable American patents.[2] In the top 1 percent of highly cited patents issued from 1975 to 1981 Japanese-held U.S. patents were proportionately overrepresented in automotive, electronics, photographic and photocopying technologies — with electronics showing the most rapid growth. The issue of dependence on Japanese technology, though, is both broader and narrower than Japan, or Japanese electronics, or even Japanese-sourced ceramic packages for integrated circuits. Since the sense of growing dependence is only recent, much of the discussion to date has been hampered by weak logic and poor data. Fortunately, several good studies have emerged that clarify the policy problems and that investigate the quantitative nature of dependency.

Three questions are central to a better understanding of the apparently growing dependence of U.S. defense production on foreign sources:

- What are the policy concerns?
- What are the dimensions of the actual use of foreign inputs?
- What policies could mitigate the problems?

What Is the Problem?

Most analysts differentiate between "dependence" and "vulnerability." Dependence in a military equipment context simply means that an input comes from a foreign source. Dependency becomes vulnerability when the loss of this foreign source would have a significant negative effect on U.S. national security by precluding the production of a critical military system or resulting in less system capability.[3]

Before jumping into the subject of vulnerability, it is useful to recognize that global access to technologies, products and skills is an asset as well as a potential problem. On the plus side a larger, more diverse pool than is available only within the United States confers many advantages. Dispersion of sources reduces the risks from disruptions occurring in a specific region or country. Overseas sources may be closer to where items may be used in warfare. A multiplicity of sources increases the likelihood of more favorable costs, quality or technology than if supply were confined only to the United States. The presence of many international market participants enhances the level of competition, with probable payoffs in future costs and technological developments. Indeed, prior to and during World War II, this nation acquired important military technologies from abroad, including radar and jet engines. Dependency, by and large, confers advantage.

Vulnerability is the problem that warrants attention. The analytical issue is to devise policies that reduce the risks from global interdependence and its potential vulnerabilities while not forsaking the benefits. The notion of vulnerability cannot be separated from time scales and scenarios. For example, a desperate need for spare parts in a high-intensity war with lines of communication under attack conveys quite a different perception of vulnerability than peacetime defense production. The policies that deal with one set of contingencies, therefore, may be irrelevant to another. The urgency of supply is closely tied to scenarios of use. Today's likely scenarios include peacetime, small-scale conflicts (Grenada), short, intense wars (Iraq), and more prolonged wars on less than a global or continental scale (Vietnam and Korea). Omitted from this list are the World War II and U.S.-Soviet types of conflicts that dominated mobilization plans for decades.

Supply disruptions can result from many different causes. Armed destruction of supply lines is the classical military disruption; submarine attacks on shipping is an example of such an action. Natural disasters, local political instability, economic collusion, terrorism, labor strikes, regional conflict and economic instability are among the other causes of disruptions that have occurred. In a national emergency or for specifically designated defense systems the Defense Production Act can compel delivery from U.S.-based firms, but it cannot overrule the effects of tornadoes, earthquakes, terrorism or bankruptcy. For many of these possible sources of problems the probability of disruption is not necessarily greater from a foreign source than from an American supplier.

Politically motivated cutoffs of supply recently have come under closer scrutiny. "The contemporary movement toward globalization opens the door in peacetime to foreign influence, foreign control, and foreign domination," wrote Theodore Moran in a 1990 article on the expanding supply line of U.S. defense producers.[4] Perhaps this view has such a currency among American analysts because the United States has been the chief user of supply cutoff as a foreign policy tool; this use naturally leads to a fear of similar behavior by others. The United States has withheld computers and technology from France to retard its strategic missile developments, a policy later reversed; threatened to cut off oil supplies to Great Britain and France during the Suez crisis; and denied arms sales to the Middle East for foreign policy reasons. The U.S. government has attempted to influence the subsidiaries of American firms in Europe to promote Washington's policies toward China, the Soviet Union and the Middle East. European experience demonstrates a real threat of interference, even from close allies. The United States itself was the victim in 1973 of a petroleum embargo by the Organization of Petroleum Exporting Countries; for the following decade such a possibility figured prominently in anxieties about other strategic imports.

Concern over a different kind of U.S. vulnerability has arisen in recent years as Japan has grown in importance as a supplier of advanced electronics components, electronics production and test equipment, and machine tools. Coupled with this new fear that another country will develop leading-edge technologies and achieve the production capabilities to turn out militarily critical products is the worry that the United States will have insufficient access in either war or peace to advanced equipment and products and thus be prevented from developing and producing the best military systems possible. In addition, lack of access could affect adversely the Pentagon as buyer and the defense industry as supplier by reducing their astuteness and competence in the conceptual development of new systems. Designers and engineers often point out that frequent iterations and feedback are necessary in producing the designs of new systems and figuring out the various trade-offs. Geographical proximity, common language and shared national interests, it is alleged, can help overcome the organizational and the commercial barriers that retard such interchange.

Disruptions of supply or poor access to a product or process technology translate into vulnerability only if they cause a significant loss of military capabilities. Many items are not critical because they perform only a peripheral role or have many substitutes. Cloth and leather for uniforms and boots are examples. Other items may be essential for some scenarios but not for others. For example, during the conflict in Iraq production was not contemplated for major platforms such as the F-16 aircraft, but worrying shortages developed for electronics spare parts for the F-16 radar. A larger and longer conflict could have transformed F-16 production dependencies into a vulnerability. Multiple sources, whether different companies or countries, reduce the criticality of any one source. Over the longer run substitutability among materials, parts, subsystems and entire systems can reduce potential vulnerabilities.

The possibility of politically instigated supply disruptions depends on the state of political relations with the supplying nation. America's most common sources of foreign products are countries with which it has the closest political ties. In fact, most military analysts consider Canadian sources to be equivalent in reliability to U.S. suppliers. Great Britain, Germany and Japan possess higher vulnerability rankings only because of their greater distance from the United States. One report evaluates the access to technology from close allies as a major asset but acknowledges the potential for somewhat greater risk than from domestic sources.[5] Regardless of the level of friendliness, however, there is always greater political risk associated with foreign suppliers than domestic sources.

The likelihood of a problem developing from dependence and vulnerability depends on the probability of a cutoff that could leave the U.S. defense establishment with a significant loss of capability. The probability of loss increases with the concentration of sources, the difficulty of substitution, the antagonism of the originating country, the criticality or essential nature of the item, the urgency of its need, and the distance from the user. For leading-edge technologies long-run vulnerability may arise if access is difficult.

Measures of Dependency

U.S. thinking about defense dependency on foreign supplies has progressed from an impressionistic level relying on anecdotal evidence, to a stage of structured but partial studies examining the first few tiers of supply, and finally to a more thorough understanding based on investigations probing four levels of supplier relationships. The most detailed study to date was performed by the Department of Commerce's Office of Industrial Resource Administration for the U.S. Navy.[6] This study made use of Commerce's mandatory data collection authority under the Defense Production Act to conduct a complete assessment of the subcontractor supply chain for three Navy systems: the high-speed, antiradiation, air-to-surface missile (HARM); the Mark-48 ADCAP (advanced capabilities) torpedo; and the Verdin submarine communications system. These systems were chosen as representative of the broad range of Navy systems and technologies.

The prime contractors and the major subsystem subcontractors (first-tier suppliers) were asked to identify each of the 1988 domestic and foreign sources (second tier) from which they purchased products or services in support of the particular weapons system. The domestic firms identified in this survey were sent questionnaires seeking information on their suppliers (third tier), and so on through the next tier. The overall response rate was 63 percent. By the time of the survey some of the identified firms had gone out of business; others had been mistakenly identified. The adjusted response rate was closer to 80 percent.

One of the striking findings of the Commerce study is the large number of firms contributing to defense production. For just a single system, the HARM missile, more than 4,000 firms were identified as fourth-tier suppliers. Overall, the study elicited responses on 11,638 active subcontractors in the United States and 1,043 abroad, including multiple mentions of the same companies. After taking account of this duplication participant numbers drop to 6,747 domestic firms and 327 foreign; at least 28 of the foreign suppliers were American-owned. Table 1 presents the number of foreign and domestic firms by system and supply level; the listings include multiple citations of some companies. The number and the proportion of foreign participation climb sharply at lower levels of the supply chain. The study found no foreign firms in the top group of contractors but 12.1 percent in the lowest group. The pattern across systems suggests greater rates of foreign activity for the more electronically oriented systems like the Verdin.

Counts of the number of firms, however, give little sense of the products supplied by foreign manufacturers, their value or how essential they are. Table 2 gives an account of the number of separate items coming from the leading countries for all three systems. Again, the volume of foreign contributions increases markedly at lower tiers. The number of countries involved rises strikingly from just three in the second tier to 39 in the fourth tier. Also, Japanese firms increase in importance at the lower levels. Japanese parts do not show up at all as direct inputs to the prime and the major subsystem contractors; however, Japan is the leading foreign supplier to third-tier producers.

By dollar value foreign contributions vary greatly across weapons systems and supplier tiers (see Table 3). Foreign purchases accounted for almost 40 percent of the total for the Verdin system's second-tier contractors but only 4.7 percent for the HARM missile. Japanese companies were the main suppliers to second-tier producers for all three systems, but their position varied at the next lower tier. According to this evidence, Japan is an important supplier to America's defense industry, but that nation does not dominate quantitatively along the various dimensions examined above.

Table 1: **Number of Identified Firms by Supplier Tier and Weapons System, 1988**

	Tier 1		Tier 2		Tier 3		Tier 4	
	Total	Foreign	Total	Foreign	Total	Foreign	Total	Foreign
HARM	6	0	765	13	1,904	106	4,149	593
MK-48	5	0	211	1	1,065	11	2,060	156
Verdin	2	0	193	1	425	52	866	110
Total	13	0	1,169	15	3,394	169	7,075	859

Source: Department of Commerce, Office of Industrial Resource Administration, *National Security Assessment of the Domestic and Foreign Subcontractor Base: A Study of Three U.S. Navy Weapon Systems* (Washington, D.C.: March 1992), Table 1, p. 16.

Table 2: **Number of Foreign-Sourced Items by Leading Country for Three Weapons Systems, 1988**

Prime Contractors from Tier 2

Number of Countries	3
Total Items	10
United Kingdom	5
Canada	4
Germany	1

Tier 2 from Tier 3

Number of Countries	22
Total Items	108
Germany	20
Japan	20
Canada	10
United Kingdom	10
France	9

Tier 3 from Tier 4

Number of Countries	39
Total Items	186
Japan	56
Canada	27
Germany	25
Taiwan	14
Sweden	13

Source: Department of Commerce, Office of Industrial Resource Administration, *National Security Assessment of the Domestic and Foreign Subcontractor Base: A Study of Three U.S. Navy Weapon Systems* (Washington, D.C.: March 1992), Tables 19-21, pp. 53-56.

The great surge in foreign direct investment in the United States in the 1980s generated concern among defense planners that foreign ownership of defense contractors could be a potential problem. Commerce analysts were able to segregate such firms in their sample. Defense-related shipments for the three examined systems by foreign-owned domestic facilities comprised 2.32 percent of system shipments by the firms included in the survey (see Table 4). British-owned companies accounted for more than half of the foreign share. Japanese-affiliated company shipments came to only 0.5 percent. Neither foreign-owned firms in general nor Japanese companies in particular are major players in the American defense market.

Table 3: **Foreign Purchases by Weapons System, Leading Country and Supplier Tier, 1988**

HARM Missile

Tier 2		Tier 3	
Percent Foreign	4.7%	Percent Foreign	17.6%
Total Foreign	$60 million	Total Foreign	$582 million
Japan	23	Canada	355
United Kingdom	8	United Kingdom	50
Germany	8	Japan	47
Switzerland	5	South Africa	32
France	5	France	23

MK-48 Torpedo

Tier 2		Tier 3	
Percent Foreign	5.3%	Percent Foreign	5.1%
Total Foreign	$8.5 million	Total Foreign	$69 million
Japan	6.5	Japan	11
United Kingdom	2.0	Netherlands	9
		China	8
		Germany	7
		Taiwan	5

Verdin Communications System

Tier 2		Tier 3	
Percent Foreign	39.8%	Percent Foreign	8.8%
Total Foreign	$100 million	Total Foreign	$28 million
Japan	70	Taiwan	10
Italy	17	Switzerland	7
Germany	6	Germany	5
Thailand	5	Japan	2
Mexico	3	Finland	2

Source: Department of Commerce, Office of Industrial Resource Administration, *National Security Assessment of the Domestic and Foreign Subcontractor Base: A Study of Three U.S. Navy Weapon Systems* (Washington, D.C.: March 1992), Tables 10-12, pp. 33-35.

A question that comes up frequently in nondefense as well as defense circles is whether foreign-owned firms in the United States tend to purchase more of their inputs from abroad than do companies owned by domestic interests. Evidence from the defense subcontractor base suggests a mixed answer. Foreign-owned second-tier firms purchase about the same proportion of their inputs from foreign sources as domestic firms (see Table 5). Third-tier firms, in general, look more to foreign sources; the foreign-owned group engages in 40 percent more foreign buying than their domestically owned counterparts.

A qualitative evaluation of the dependency information is necessary to determine whether foreign sourcing is a potential problem. With respect to foreign-owned U.S. firms, Commerce's review of the products produced by these firms indicated that similar capabilities existed among U.S.-based producers. Furthermore, current U.S. law enables the president to require defense deliveries from a domestic facility on a preferential basis, regardless of ownership. Despite the tendency of foreign-owned firms to import more from abroad, they do not appear to represent a vulnerability — mainly because of the existence of other sources.

Table 4: **Defense Shipments of Foreign-Owned U.S. Facilities for Three Weapons Systems, 1988**

Country of Ownership	Defense Shipments (millions of dollars)	Share of All Defense Shipments
United Kingdom	$149.7	1.30%
Japan	53.7	0.47
France	33.4	0.29
Germany	14.6	0.13
Hong Kong	4.0	0.03
Foreign Total	267.1	2.32

Source: Department of Commerce, Office of Industrial Resource Administration, *National Security Assessment of the Domestic and Foreign Subcontractor Base: A Study of Three U.S. Navy Weapon Systems* (Washington, D.C.: March 1992), Table 7, p. 29.

Table 5: **Foreign Purchases for Three Weapons Systems by Domestic and Foreign-Owned Suppliers (1988)**

(share of total purchases)

	Ownership	
Supplier Tier	Domestic	Foreign
Tier 2	6.5%	6.9%*
Tier 3	13.7	19.6

*One outlier removed.

Source: Department of Commerce, Office of Industrial Resource Administration, *National Security Assessment of the Domestic and Foreign Subcontractor Base: A Study of Three U.S. Navy Weapon Systems* (Washington, D.C.: March 1992), Table 8, p. 30.

When Commerce asked suppliers for the reason they bought foreign-made items, one of the most numerous responses (239) was higher quality; 169 mentioned lower price. Of the respondents that purchased raw or processed materials from overseas, 242 said that the United States had no economically viable mining capacity. Respondents named 17 different materials in this category, but 95 percent of the value was concentrated in only nickel, ferrochrome and tantalum. Strategic stockpiles, the traditional solution to the problem of dependency on bulky materials, exist for these items and for most others with single-country suppliers. For other materials sufficient dispersion of sources appears to reduce the vulnerability potential. A large share of foreign dependency, therefore, was stimulated by economic motivation. For materials not available domestically, strategic stockpiles or multiple sources minimize the anxieties over dependence.

The sanguine situation described above, though, does not extend to every part and material examined. A few cases stand out. For example, over 82 percent of the ceramic packaging for semiconductors came from Japan — most from a single company. Ironically, although domestic companies made ceramic packaging, most users were unaware of the local supplies. Nevertheless, this product represents a potential vulnerability because of lower domestic quality and a tendency to concentrate on a single source.

Another common dependency problem lies in needle-bearing wire rod; defense contractors contend no U.S. sources manufacture rod of the required high quality. Sourcing was scattered among eight firms in three countries, with 80 percent coming from six Japanese firms. The importance of this product lies in its use in precision bearings, which are critical components in many military systems. Thus, the relative concentration of wire rod capabilities abroad creates a potential vulnerability.

Another concern is that some stockpiled materials are of insufficient quality for current high technology needs. Therefore, even though the quantities appear to be sufficient for emergency use, they could fail to meet production requirements.

Among other studies that have examined dependency on foreign suppliers is one by the Institution for National Strategic Studies of the National Defense University, which examined the foreign sources of 17 precision-guided munitions, including air, sea and ground-based missiles, a torpedo, a bomb and an artillery round.[7] The main sources of information were 500 companies identified as suppliers of at least one major PGM part; these companies were asked to list their foreign suppliers. The authors estimated that their 60 percent response rate covered about 80 percent of the value of the sample of PGMs under investigation. This survey method would have covered roughly the second and third tiers of suppliers. The foreign parts that were identified were further classified into two groups: those related to integrated circuits and everything else.

The survey response of almost 300 subcontractors revealed 27 instances of foreign dependency. Among this group were foreign suppliers of parts for eight high-cost subsystems, shown in Table 6. U.S. sources had the capability to produce parts for seven of the eight subsystems and indicated that domestic supplies could replace the foreign components with a two- to three-month lead time under wartime conditions.[8]

The study's authors defined two other subclasses of foreign parts: low- and high-incidence subcomponents used in one and more than one system, respectively (see Table 7). Seven of these 14 components came from Germany and three from Japan; the Japanese components included precision optics and two types of field-effect transistors for use in high-frequency radars. American plants claimed to be able to produce the FETs with a one-year lag; the optics were sourced from Germany as well as Japan, with a U.S. company as an alternative. Alternative providers for certain types of complex ferrite cores and high-purity silicon were not easily identified, the study noted. Otherwise, no great difficulties were foreseen in finding existing domestic producers or in getting a new producer on-line within a year.

Integrated circuits presented a more complex story. The extent of the defense industry's foreign dependence was so broad that the researchers estimated that a cutoff would hurt production severely.[9] Military contractors rely on overseas facilities for assembly of domestically produced chips, a large percentage of silicon wafers, most of their ceramic packages, metal parts for nonceramic packages and the raw glass to make glass masks. In assessing vulnerability the analysts noted that production of all the currently dependent items could be undertaken in the United States, perhaps at a cost disadvantage, with sufficient lead time. However, because of the pervasiveness of foreign IC suppliers and because of the trend toward even greater foreign sourcing in 1987 when the study was written, the researchers warned against complacency in not addressing potential future problems. Their preferred solution to vulnerability was the use of stockpiles in the form of larger active inventories.

Table 6: **High-Cost Precision-Guided Missile Subsystems from Foreign Sources, 1985**

Program	Item	Country
Stinger	Launch tube	Israel
Harpoon	Extrusions	Australia
HARM	Actuator	United Kingdom
HARM	Gear motor	United Kingdom
Standard	Castings	Israel
Harpoon	Rocket motor case	United Kingdom, Australia
Skipper	Rocket motor case	United Kingdom
HARM	Rocket motor case	United Kingdom

Source: Martin Libicki, Jack Nunn and Bill Taylor, *U.S. Industrial Base Dependence/Vulnerability; Phase 2 — Analysis* (Washington, D.C.: National Defense University, November 1987), p. 118.

Table 7: **Low- and High-Incidence Precision-Guided Missile Subcomponents from Foreign Sources (1985)**

Item	Source	Incidence
Ball Screws	United Kingdom	Low
Copper Liner Forms	Switzerland	Low
Bearings	Germany, other	Low
Molybdenum Foil	Austria	Low
Printed Wiring Board Plating Bath	United Kingdom	Low
Springs, Pivots	Germany, South Africa	Low
Radome Chemicals	Germany, Mexico	Low
Silicon Field-Effect Transistors	Japan	High
Gallium Arsenide Field-Effect Transistors	Japan	High
Ferrite Cores	Germany	High
Precision Optics	Germany, Japan	High
Sapphire	Switzerland	High
Butane Triol	Germany	High
High-Purity Silicon	Germany	High

Source: Martin Libicki, Jack Nunn and Bill Taylor, *U.S. Industrial Base Dependence/Vulnerability; Phase 2 — Analysis* (Washington, D.C.: National Defense University, November 1987), pp. 120 and 126.

A 1990 study by the Institute for Defense Analyses arrived at conclusions that were quite close to the National Defense University report described above. IDA looked at the display components in aircraft cockpits (the AV-8B, the F-18 and the P-7 aircraft), the microelectronics of two generations of aircraft radar (the APG-66 and the APG-68 on the F-16), the subsystems on two missiles (the AIM-7 Sparrow and the AIM-120 AMRAAM or Advanced Medium-Range Air-to-Air Missile), and large combat vehicle engines.[10] Although the survey of the supply chain was neither as systematic nor as thorough as the studies reviewed above, the findings and the conclusions had the same tone.

> The study found no case in which foreign technology sourcing appears to threaten imminent risk of supply disruption. However, it did find several technologies now heavily dependent on foreign sources in which reconstitution of U.S. production capabilities could face delays of several years ... .[11]

Among the components cited as being at greatest risk of such disruption were microelectronic devices, ceramic packages, silicon, gallium arsenide, ferrite coils and filter glass. All of these items also were identified in the other studies. Production equipment deficiencies showed up in certain high-precision numerically controlled machine tools and semiconductor manufacturing equipment, now sourced mainly from Japan. The radar evaluation noted that 99 percent of the ceramic bases for integrated circuits were imported, with almost as high proportions for the lead frames and covers.

IDA analysts also expressed concern about high-resolution display technologies, but these worries mainly reflected projected future trends. Most current aircraft cockpit displays rely on cathode-ray tubes. Flat-panel displays are only slowly replacing CRTs because of the high cost of the new technology and technical problems that have yet to be resolved over extreme brightness in the cockpit environment. Foreign components in the examined CRT displays are shown in Table 8. The most significant foreign dependency problems are associated with optical filters, filter glass and molded ferrites. Each of these products come from a single Japanese company. Moreover, several years would be required before alternative domestic supplies could be made available. The evaluation of flat-panel displays noted the relatively weak and undeveloped state of domestic technologies for defense systems.[12]

Analysis of the Sparrow and AMRAAM missiles revealed little use of foreign parts and components at the first and second tiers. At lower tiers the chief offshore supplies consisted of microelectronic components, especially ceramic packages and gallium arsenide substrates. Missile foreign dependencies are shown in Table 9. The AMRAAM missile incorporates more recent technology than the latest Sparrow model. Electronics dominates the AMRAAM design, primarily in the guidance section — which comprises 77 percent of the weapon's cost. Only 2 percent of the cost is embodied in the armament, 3 percent in the airframe, 5 percent in propulsion and 8 percent in the control section. (Five percent of the missile cost is incurred in the assembly process.) Because of the importance of its electronics, the AMRAAM is more heavily dependent on foreign sources than the older Sparrow.[13] Except for the familiar microelectronic components, procurement was driven offshore mainly by costs. The United States was estimated to have the capability to produce the items but with varying delays. Materials dependence could be met by stockpiles, the IDA report said.

IDA's examination of tank engine sourcing revealed no foreign components in the AGT-1500 turbine engine on the M-1 tank. Two new engines were competing for the U.S. Army's advanced engine program. One of these, the LV100, was designed jointly by General Electric Co. in the United States and Motoren-und-Turbinen Union in Germany. The LV100 has three subsystems developed and currently manufactured in Germany. However, during production GE contractually is required to use American-built parts. The other advanced engine is Cummins Engine Co.'s XAV28. Its foreign components include a fuel injector solenoid built in Japan and head bolts from Germany. The solenoid contract was given to a Japanese firm when the U.S. bidder required $750,000 for development tooling. The Japanese bidder agreed to redesign a commercial product at no cost to the

Table 8: **Foreign Cathode-Ray-Tube Cockpit Display Parts**

Aircraft	Item	Source	Reason for Foreign Sourcing	Delay for Alternate Source
F-18	Filter glass and filter	Japan	Only source	5-6 years
F-18, AV8B	Molded ferrites	Japan	Size of buy; part complexity	4-5 years
F-18, AV8B	Glass bulb for CRT	Japan, Germany	Quality; few sources	1 year+
F-18, AV8B	Electronic cards	United Kingdom, United States	Cost	6 months-
F-18	Chassis casting	Canada	Offset agreement	6 months+
F-18, AV8B	CRT enhancement filter	Germany	Quality not available domestically	1 year+
F-18, AV8B	Miscellaneous display components	United Kingdom	Unique components	1 year+
F-18, AV8B	Test equipment	United Kingdom	Cost	3 years+
P-7	Phosphors	Japan	Quality not available domestically	1 year
P-7	Glass funnel	Germany	Quality; few sources	1 year+
P-7	Glass faceplates	Germany	Quality; few sources	1 year+
P-7	Color display	Japan	Quality; cost	1 year+

Source: Erland H. Heginbotham *et al.*, *Dependence of U.S. Defense Systems on Foreign Technologies* (Alexandria, Virginia: Institute for Defense Analyses, December 1990), p. 16.

Table 9: **Foreign Missile Parts**

Missile Type and Sector	Item	Source	Reason for Foreign Sourcing	Delay for Alternate Source
AMRAAM guidance	Magnesite for radome	Mexico	Only source	Indefinite
AMRAAM guidance	FETs and capacitors	Japan	Cost	n.a.
AMRAAM guidance	Ceramic chip carriers	Japan	No domestic supplier	Indefinite
AMRAAM guidance	Hybrid circuit components	Asia, Europe	Cost	6 months
AMRAAM guidance	Gallium arsenide	Japan	No domestic supplier	1 year+
AMRAAM guidance	Actuator motor	United Kingdom, United States	Cost	None
AMRAAM warhead	Titanium	Australia	No economic U.S. source	n.a.
AMRAAM warhead	Chromium	South Africa	No U.S. source	Indefinite
AMRAAM rocket motor	Propellant chemical (IPDI)	Germany	EPA regulations	Short
AMRAAM rocket motor	Flow-form machine	Germany	Cost	1 year-
Sparrow rocket motor	Propellant chemical	Germany	n.a.	n.a.
Sparrow rocket motor	Flow-form machine	Germany	Cost	1 year-

Source: Erland H. Heginbotham *et al.*, *Dependence of U.S. Defense Systems on Foreign Technologies* (Alexandria, Virginia: Institute for Defense Analyses, December 1990), p. 23.

Army. In the case of the head bolts, foreign supply of the set of 40 required for each engine represented a savings of $3,000 per engine.[14]

Policy Implications: Reducing Vulnerabilities

The evidence on foreign inputs going into U.S. weapons systems shows that foreign dependency seems to be growing, that most offshore sourcing arises from commercial decisions based on cost and quality considerations, and that a limited number of components represent unique foreign manufacturing or technological capabilities. Especially at the lower supply tiers, most of the pieces, parts and supplies are the ordinary stuff of production. Many of the domestic companies, when surveyed, were unaware that their shipments were to be used in military systems.[15] Foreign supplies destined for defense products follow this same pattern: at the lower tiers most imported parts are just "stuff."

The pattern of defense-related foreign inputs follows the general structure of American merchandise imports. America's leading overall import sources are Canada, Japan, Mexico, Germany, Taiwan, and the United Kingdom. Except for Mexico, these are the same countries that dominate the defense supply list. America's main allies in the North Atlantic Treaty Organization — Canada, Germany and the United Kingdom — are the chief suppliers of specifically military items: rocket motor cases and aircraft ejection seats, for example. However, they, and the other supplying countries including Japan, mainly export broader classes of industrial goods. For most such goods the familiar notion of "dual use" loses much of its meaning. Whether it is copper foil or bearing wire, or any of several hundred other items, these are not dual-use but multiple-use products.

The appropriate focus of policy is, thus, on a small number of key items and materials that subsequently find their way into many weapons. These often come from a limited number of sources, perhaps a single country and sometimes a single company. When coupled with the absence of alternative sources, this situation yields the raw material for vulnerability.

Policies can eliminate or mitigate the potential costs of disruption or lack of access. Taken as a whole, such policies are a form of insurance against uncertain, harmful events. But insurance is rarely free. An investment in insurance attempts to shift resources from a period of calm to a future occasion of disruption when the items in questionable supply would have a highly time-urgent value. Decisions to invest in insurance depend on expectations about the type, magnitude, timing, duration, frequency and, especially, the cost of the future disruption. The analytical policy problem is to balance the cost of insurance with the benefits that the insurance is expected to provide by reducing or compensating for the possible losses.[16]

Policies to insure against foreign supply vulnerabilities can take many forms: military defense of supply lines; alternative transport routes and modes; economic, political or military pressures to counter politically motivated cutoffs; dispersion of sources of supply; creation of new sources; substitution of alternative materials, parts or even entire systems; redesign around critical items; and stockpiles. One policy that often is recommended as a solution to a perceived foreign dependency problem — domestic production — may be too narrowly conceived. As Georgetown University's Theodore Moran points out, the promotion of a national champion that is less than successful can lead to a nightmare for defense industrial strategists in "... being tied to a product of such high price, long delays, and inferior technological performance that the user finds his own security compromised."[17]

Mr. Moran's policy advice focuses on eliminating concentrations of supply. "Diversification and multiplication of the companies and locales upon which a nation can draw offers the most dependable method for minimizing the threat of foreign control."[18] He goes on to say, "The real test for whether a threat to national security exists is not whether a subsector of a particular industry appears headed for extinction on American soil, but whether the emerging array of suppliers is so concentrated that it offers the potential for foreign political interference."[19] Concentration obviously raises the probability for all types of disruption. Mr. Moran proposes a "4/50" rule of thumb to assess the degree of concentration. To avoid political interference no four countries should supply more than 50 percent of the arm's-length world market; to avoid restrictive behavior by corporations no four firms should control more than 50 percent of the market. Concentration measures that violate this threshold are a signal for further action. While the specific numbers of this rule are debatable, the chief point is that policy can be used most appropriately to reduce concentration — political and economic.

One such policy action is the creation of stockpiles. Stockpiles have two main effects: they act as a deterrent to political or commercial restrictions, and they are a ready source of supply if disruptions should occur. The cost of building up stockpiles for the 22 classes of foreign products discussed in the study on dependency for precision-guided missile parts was nearly $15 million. The cost is the one-time investment for building an active inventory of parts, scaled to support production until new supplies would be forthcoming. Such a stockpile is not intended to be locked up in a bonded warehouse but to be continuously drawn on and replenished. The calculations of stockpile costs for the precision-guided missile parts took into account the unit costs of the items, the peacetime production rate and a surge rate, plus the length of time it would take to get an alternate source of supply into production (these times varied from two to 12 months). The estimated cost came to $12 million, with an additional $2.7 million to support surge production.[20] The authors noted with some surprise that the $15 million price tag for guarding against disruption seems rather small considering the roughly $6 billion spent annually for PGMs. Extrapolating from these rather optimistic figures, the cost of ensuring a full year's stock for every item would come to only about $30 million. The true economic cost of such a buffer is just the interest on the full amount, or roughly $3 million per year at a 10 percent rate of interest. Since a stockpile guarantees availability, in many ways it provides the greatest amount of insurance. Other policies, presumably, could yield similar benefits at lower cost.

The estimated $30 million stockpile cost for a year's supply, if distributed according to source by country, would show the United Kingdom in first place with $16.4 million, followed by Japan at $4.1 million and Germany at $1.4 million. A year's supply of integrated circuit components and FETs would come to $3.1 million.

Government need not operate the stockpile to gain the desired degree of self-sufficiency. Rather, through contractual penalties and explicit requirements, it could provide incentives to prime contractors to achieve continuity of production in the face of potential disruption. Contractors could choose, for example, to maintain sufficient inventories, secure multiple sources of supply, change the product design or, when considering the cost of insuring against vulnerability, the contractor may decide to buy from a domestic company that charges higher prices than foreign competitors. In any event, by giving incentives to its suppliers, the government can help to achieve more efficient solutions than if it simply dictated a specific approach.[21]

The policy of promoting the dispersion of sources addresses the problem of denied access to equipment and cutting-edge technologies — whether for products themselves or the methods for producing them. With low concentration, discrimination against American buyers by state-of-the-art producers would be difficult to practice without collusion since the technologies or products would come from diverse sources. To encourage American capabilities in advanced defense technologies Mr. Moran recommends that the government grant top priority to funding research and development programs plus perhaps finance the early commercialization of projects with high defense payoffs but low commercial use. He also suggests that the government use various tax, subsidy and other levers in international negotiations to support the creation of new facilities on American soil. For example, the United States could allow companies from friendly countries to participate in government-funded research programs but require them to carry out the R&D in American facilities with subsequent production sited in the United States or a third country.[22] He specifically warns against government promotion of technologies with high commercial interest and expresses serious concern about protectionist measures that could encourage inefficiency and lower levels of innovation.

Defense analyst Jacques Gansler of The Analytic Sciences Corp. has recommended greater military use of off-the-shelf commercial items and less devotion to military specifications. Under this rationale, if the military could be weaned away from its MILSPEC orientation, the number of alternative sources would increase and the vulnerability potential decline. For example, the authors of several of the dependency studies question the military requirement for ceramic packages for integrated circuits. Commercial-use plastic packages should suffice for most applications except when high hermetic qualities are required — and even then the special qualities of ceramics are open to dispute.[23]

On the political side the U.S. government may be able to negotiate agreements with its allies to provide supply priorities during emergencies and nondiscrimination in technology access during peacetime. The United States currently has a broad range of security agreements covering such behavior as intelligence sharing and overflight privileges and procedures. As supply networks become more globalized, it may be appropriate to address access issues in international relationships.

Several of the studies reviewed above considered the American dependency on production equipment, such as high-precision, multiple-axis, numerically controlled machine tools. This analysis was not discussed here because most of the production equipment dependencies would not lead to vulnerabilities if their supply were disrupted under the scenarios contemplated above. Only a large-scale, multiyear war with high rates of sustained production would put production equipment on the essential list. Given the length of time implied by this scenario, which most analysts now consider to be quite unlikely, finding alternative sources of parts or production equipment does not seem to be a critical problem.

A central point that emerges from a review of the evidence and the logic of dependence is that the diffusion of economic development and technological capabilities, when combined with the increased interdependence of the world's markets, almost guarantees that the United States will look increasingly to global sources for its defense technology, supplies and even final systems. It stretches credulity to think that any one country could be supreme in every sector, every process and every input. Even if the United States could achieve supremacy, economic analysis indicates that this country would be better off by specializing in those things it does best.

Conclusion

The problem of vulnerability in defense procurement is real, but its scale is limited. Policies to mitigate the possible effects of vulnerability can be managed at a reasonable cost without doing great damage to other objectives. Japan is a supplier of a small number of militarily critical items that can be dealt with at relatively low cost through the general application of broad policies.

Alexander Hamilton long ago recognized that a policy of general economic development was preferable to one that specifically favored defense suppliers. Defense needs, technologies and supply patterns can change in rather drastic fashion over the course of only a few years. Today's dependencies can become tomorrow's strengths — and vice versa. Policies that lock in the future are best avoided.

For further information, contact **Arthur J. Alexander**.

Notes

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[4] Theodore Moran, "The Globalization of America's Defense Industries: Managing the Threat of Foreign Dependence," *International Security,* XV, No. 1 (Summer 1990), pp. 57-59.

[5] Libicki, *op. cit.*, p. 31.

[6] Department of Commerce, Office of Industrial Resource Administration, *National Security Assessment of the Domestic and Foreign Subcontractor Base: A Study of Three U.S. Navy Weapon Systems* (Washington, D.C.: March 1992).

[7] Libicki, *op. cit.*

[8] Libicki, *op. cit.*, p. 117.

[9] Libicki, *op. cit.*, p. 123.

[10] Erland H. Heginbotham *et al.*, *Dependence of U.S. Defense Systems on Foreign Technologies* (Alexandria, Virginia: Institute for Defense Analyses, December 1990).

[11] *Ibid.*, p. S-1.

[12] *Ibid.*, p. 18.

[13] *Ibid.*, pp. B-III-9, B-III-10.

[14] *Ibid.*, p. B-IV-13.

[15] Department of Commerce, *op. cit.*, p. 8.

[16] Benjamin Zycher, Kenneth Solomon and Loren Yager, *An Adequate Insurance Approach to Critical Dependencies of the Department of Defense* (Santa Monica, California: Rand Corp., 1991), pp. 2-3.

[17] Moran, *op. cit.*, p. 67.

[18] Moran, *op. cit.*, p. 69.

[19] Moran, *op. cit.*, p. 85.

[20] Libicki, *op. cit.*, pp. 44-45.

[21] Libicki, *op. cit.*, and Zycher, *op. cit.*, make these points.

[22] Moran, *op. cit.*, p. 82.

[23] Libicki, *op. cit.*, p. 125.

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REPORT

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Government Braces Banks, Sparks Stock Market Rally

After months of steadfastly denying that slower economic growth, stagnant real estate markets and slumping equity markets were putting financial institutions in a bind, the cabinet of Prime Minister Kiichi Miyazawa abruptly changed its tune in mid-August. In announcing a package of emergency measures designed to bolster bank balance sheets and promising further actions Finance Minister Tsutomu Hata sought to break the bear hug of negative sentiment that was gripping the stock market. With a sigh of relief investors responded positively to the government's new attitude by driving the Nikkei average of 225 first-section stocks on the Tokyo Stock Exchange up more than 16 percent in four days of trading. Market analysts still are not convinced that the market has found firm support among investors and are waiting to see whether the gain has stamina or whether it will repeat the pattern of this past June and July (see Graph).

Following a drop to just above the 15,000 mark in late July (see *JEI Report* No. 29B, July 31, 1992), the Nikkei average struggled upward to close at 15,983.64 August 5. Reports of poor corporate profits, however, drove the market down six days straight to close at 14,768.17 August 13, a 7.6 percent decline. After fighting back to nearly 15,000 over the next two days, the Nikkei plunged 620.14 points August 18 to close at 14,309.41, its lowest level in more than six years. Analysts began hypothesizing that the market easily could fall below 14,000 and that the bottom lay as low as 11,000.

Japanese banks are caught between a rock and a hard place. Falling equity prices reduce the value of banks' stock portfolios (40 percent of which counts toward their overall capital base) just as

Trade and Payments Data

(in millions of dollars unless otherwise indicated)

	1990	1991	January-June 1991	January-June 1992	April 1992	May 1992	June 1992
Japan's Balance of Payments							
Trade Balance	$63,528	$103,044	$44,081	$62,884*	$9,991*	$10,094*	$11,431*
Exports (f.o.b.)	280,374	306,557	146,968	159,129*	26,576*	24,816*	27,312*
Imports (f.o.b.)	216,846	203,513	102,887	96,245*	16,585*	14,722*	15,881*
Current Account Balance	35,761	72,901	28,924	56,180*	9,753*	9,486*	9,360*
Long-Term Capital (net)	-43,586	37,057	3,604	650*	-3,431*	-1,893*	-7,432*
Overall Balance	-7,234	76,369	-3,262	58,848	3,250	9,557	-492
International Reserves (end of period)	77,053	68,980	67,892	67,444	68,145	68,050	67,444
Japan's Customs Clearance Trade							
Trade Balance	52,149	77,789	32,177	49,046	7,192	7,854	8,985
Exports (f.o.b.)	286,948	314,526	150,330	163,315	27,248	25,495	28,128
Cars	41,348	44,713	21,450	24,286	3,962	3,389	3,797
Steel	12,509	13,612	6,645	6,341	1,018	1,102	1,114
Imports (c.i.f.)	234,799	236,737	118,152	114,269	20,056	17,641	19,143
Crude Oil	31,584	30,181	15,438	13,796	2,613	2,095	2,155
Manufactured Products	118,028	120,341	59,033	58,000	9,856	8,843	9,725
Japan-U.S. Trade							
Trade Balance	37,954	38,220	15,882	18,599	3,294	2,914	3,149
Exports (f.o.b.)	90,322	91,538	42,614	44,892	7,536	6,993	7,592
Imports (c.i.f.)	52,369	53,317	26,732	26,293	4,243	4,079	4,443
Yen-Dollar Exchange Rate (average for period)	Y144.79	Y134.71	Y136.08	Y129.36	Y133.57	Y130.57	Y126.81
U.S. Trade							
Trade Balance	-101,718	-65,399	-23,922	-28,679*	-5,705	-5,389	-6,479*
Exports (f.a.s.)	393,592	421,730	210,400	224,156*	37,173	36,696	39,174*
Imports (Customs)	495,311	487,129	234,322	252,835*	42,878	42,085	45,654*
U.S.-Japan Trade							
Trade Balance	-41,105	-43,385	-19,115	-21,859*	-4,210	-3,495	-3,385*
Exports (f.a.s.)	48,580	48,125	24,461	23,826*	3,566	3,666	4,164*
Imports (Customs)	89,684	91,511	43,577	45,685*	7,776	7,161	7,549*

*Preliminary

Japanese Economic Indicators

(percent change from year-earlier period unless otherwise indicated)

	1990	1991	January-June 1991	January-June 1992	April 1992	May 1992	June 1992
Discount Rate (end of period)	6.0%	4.5%	6.0%	3.75%	3.75%	3.75%	3.75%
Outstanding Money Supply	11.7%	3.6%	4.9%	1.5%	1.6%	1.1%	0.9%
Industrial Production	4.6%	2.1%	4.5%	-5.4%	-6.1%	-8.8%	-3.7%
Manufacturing Operating Rate	2.3%	-1.4%	0.9%	-7.1%	-8.0%	-9.8%	-5.3%
Number of Bankruptcies	-10.6%	65.8%	60.2%	38.5%	48.2%	33.7%	31.2%
Residential Construction Starts	2.7%	-19.7%	-16.7%	-3.7%	0.4%	-0.1%	1.0%
Job Openings to Applications (ratio)	1.40	1.40	1.45	1.19	1.17	1.14	1.08
Nominal Wages	4.7%	3.7%	3.5%	3.1%	2.3%	2.5%	2.7%
Manufacturing Labor Productivity	4.2%	2.3%	5.3%*	-5.0%*	-5.3%	-6.5%	n.a.
Wholesale Prices	2.0%	0.2%	1.0%	-1.6%	-1.2%	-1.4%	-1.5%
Consumer Prices	3.1%	3.3%	3.6%	2.1%	2.4%	2.0%	2.3%
Yen-Based Export Prices	2.1%	-3.5%	-4.9%	-2.3%	-0.7%	-2.0%	-3.7%
Yen-Based Import Prices	8.6%	-7.9%	-3.4%	-10.1%	-6.4%	-6.3%	-7.4%

*Through May of each year only.

For Japan's latest GNP figures, see JEI Report No. 24B, June 26, 1992.

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JEI

REPORT

A Two-Part Report: A and B

NO. 34A

September 4, 1992

CORPORATE GOVERNANCE IN JAPAN

SUMMARY

Managers of publicly owned corporations are expected to maximize company profits, a process that assures the firm's shareholders the highest possible return both over the short run and the long term. Until recently Japanese corporate management did not feel it had to worry about the near-term financial interests of stockholders as long as the company produced a reasonable long-term return. This freedom partially reflects the fact that a majority of shareholders in many Japanese corporations consist of friendly institutional investors and, until recently, they rarely challenged the decisions of company executives. Moreover, the rapid growth of sales and profits through the 1980s plus the perceived low cost of capital in Japan made a longer time horizon economically rational. Buffered from the narrow concerns of stockholders, Japanese corporate officials had considerable decisionmaking flexibility.

The steep slide in Japanese stock prices since the end of 1989 has prompted institutional investors in Japan to review their management-knows-best attitudes. With their once huge paper capital gains disappearing, banks, insurers and other institutional investors have begun to urge companies in which they own stock to hike dividend payouts; otherwise, they have warned, they might consider selling their shares. A series of financial and securities market scandals over the past five years or so also has forced institutional investors to reassess their hands-off position on corporate management.

Recent efforts to strengthen corporate governance in Japan include both legislative and institutional reforms. At the most basic level firms are examining the role of outside directors and the need for an independent audit committee. These and other measures are expected to help make Japanese corporate behavior more transparent and easier for corporate monitors and companies' overseas counterparts to understand.

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Corporate Management and Shareholders

The different investment horizons of corporate managers in the United States and Japan show up on every list of the competitive strengths and weaknesses of American and Japanese companies. Business executives in this country are said to be fixated with short-term profits and the boost that strong quarterly earnings give to their company's stock price — a preoccupation that is traced in part to the quick-return investment objectives of U.S. shareholders. Management in Japan, it is argued in contrast, has the latitude to focus on the company's long-term financial performance because most of the firm's stock is held by stable, friendly institutional investors concerned more about share-price appreciation over time than immediate gains.

While the short-run, bottom-line orientation of American management is a staple of the accepted thinking about what companies in this country are doing wrong, virtually no systematic evidence has been produced to confirm that businessmen here opt for investments with less risk or shorter payback periods than market rates of return warrant. The conventional wisdom is on firmer ground, however, in linking the long-term perspective of Japanese corporate managers to the ownership of large blocks of stock by supportive institutional investors.

Banks, insurance companies, manufacturers and other institutional investors control far more of the shares of publicly owned companies in Japan than in the United States (see Tables 1 and 2). Even if the stock held by brokerage houses and investment trusts is subtracted from the institutional total on the assumption that these investors often buy and sell stock for short-term gains, roughly two-thirds of all shares in Japan still are held by businesses that have invested for the long haul.

Table 1: **Composition of Corporate Equity Ownership in Japan, FY 1955 and FY 1990**

(percentage of unit shares* of all publicly owned companies)

	FY 1955	FY 1990
Japanese Individuals	53.1%	23.1%
Japanese Institutions	45.1	72.1
Central and Local Governments	0.4	0.6
Nonfinancial Corporations	13.2	25.2
Financial Institutions	23.6	45.2
Banks and Trust Banks	n.a.	26.1
Of which: Investment Trusts	4.1	3.6
Life Insurance Companies	n.a.	13.2
Nonlife Insurance Companies	n.a.	4.1
Other Financial Institutions	n.a.	1.8
Brokerage Houses	7.9	1.7
Foreigners**	1.8	4.2

*A unit share is calculated as 1,000 shares of a ¥50 stock or 100 shares of a ¥500 stock. In FY 1990 there were 394.9 million unit shares. The FY 1990 data exclude stockholders who own less than one unit share.
**Includes both individual and institutional investors.

Source: Zenkoku Shoken Torihikijo Kyogikai, *Kabushiki Bunpu Jokyo Chosa.*

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Table 2: **Composition of Corporate Equity Ownership in the United States, 1955 and 1990**

(percentage of market value of all U.S. equities)

	1955	1990
Individuals	77.0%	46.7%
Institutions	23.0	53.3
Private Pension Funds	1.3	19.9
Bank Trusts*	n.a.	9.2
State and Local Retirement Funds	0.6	8.3
Mutual Funds	3.9	7.2
Insurance Companies	2.3	6.9
Foundations and Endowments	n.a.	1.8

*Commercial banks are not allowed to own stocks in the United States.

Source: Columbia Institutional Investor Project, cited in testimony of Richard Breeden, chairman, Securities and Exchange Commission, before the Senate Committee on Banking, Housing and Urban Affairs, Subcommittee on Securities, October 17, 1991, p. 11.

Among the long-term institutional investors in any one of the nearly 2,100 companies listed on the Tokyo, Osaka or other Japanese stock exchanges are other members of the same corporate grouping or *keiretsu*, the firm's customers, its major bank as well as other banks that provide financing, plus the insurers that handle the company's pension fund or corporate insurance. Having acquired stock in the company primarily to cement a long-term business relationship, these investors are willing to give management considerable free rein on business strategy, including the decision to retain a high proportion of after-tax income, as long as they are confident that their investment will pay off over the long run through share-price appreciation.

Reflecting the tendency of many Japanese institutional investors to hold stock on a long-term basis, the average level of cross-stockholding among *keiretsu* members has been stable since the late 1970s (see *JEI Report* No. 2A, January 12, 1990). For example, between 1975 and 1988 mutual shareholding among firms belonging to the Mitsui Group dipped only from 17.5 percent of all shares outstanding to 17.1 percent. The change was similarly limited for companies in the Mitsubishi Group (27.8 percent to 26.9 percent). The same was true of cross-stockholding within the Sumitomo Group (24.4 percent in 1988 versus 25.9 percent in 1975).

Unlike in the United States, banks in Japan are allowed to own up to 5 percent of the shares of a nonbank company; as much as 40 percent of a nonbank corporation's outstanding stock can be held by financial institutions as a group. Typically, any bank that lends to a firm owns some of that company's stock. The bank that coordinates lending to a business and oversees its financial status is expected to have the largest shareholding among banks. Therefore, a company's lead bank usually buys 4 to 5 percent of the firm's shares to demonstrate its key financial role.

While many institutional investors in Japan have bought stock in domestic companies primarily for business reasons, the run-up in Japanese stock prices over time and especially in the late 1980s added a financial rationale for keeping their money in the stock market rather than putting it elsewhere. Big institutional investors generally invested in a core group of companies before their stock was offered to the public, paying only book value for their shares. In buying stock in other public corporations they paid market prices, but these purchases often were made more than a decade ago. Regardless of the timing, the stock market boom of the late 1980s offered institutional investors potentially huge capital gains.

Impact of the Stock Market Sell-Off

Japanese stock prices have taken a beating since they reached a postwar high at the end of 1989. The Nikkei average of 225 stocks listed on the first section of the Tokyo Stock Exchange plummeted from 38,915.87 to a six-year low of 14,309.41 in mid-August, dragged down by the economy's slowing performance and an accompanying drop in corporate sales and profits as well as by a series of financial scandals and the deflation of the speculative boom of the late 1980s. This steep slide has hurt institutional investors across-the-board, but banks and insurance companies, the market's biggest investors, have been the hardest hit.

As the value of their stock portfolios has contracted, financial institutions have become increasingly concerned about the relatively low rates of return they earn on their investments in public corporations. Sukenari Ito, president of Nippon Life Insurance Co., reflected the thinking of other financial firms' executives when he recently argued that Japanese companies need to raise the rate on return of equity to the U.S. level of around 10 percent from the current figure of 6.9 percent.[1] Mr. Ito also said the proportion of after-tax income paid out by Japanese corporations as dividends should be raised from the present 30 percent or so to at least 40 percent, a change that still would leave the payout ratio well below the comparable American number (see *JEI Report* No. 15A, April 17, 1992). Some institutional investors even have hinted that they might sell their stockholdings unless corporate management responds positively to their calls for higher dividends. This threat is especially effective in an unstable stock market since it could cause further drops in share prices.

Recent stock market conditions also have caused *keiretsu* companies to question the value of mutual shareholding practices. *Keiretsu* companies are less active than financial firms in promoting higher dividends since their investments in group firms are motivated by long-term business relationships as well as the desire to keep the ownership of *keiretsu*-affiliated companies in friendly hands (see *JEI Report* No. 35A, September 20, 1991). But given the bleak prospects for financial returns, even these investors are beginning to reassess their stockholding rationales.

According to a May survey by *Nikkei Business* of the companies listed on the TSE's first section (excluding banks), 53 percent of the 220 firms that responded said they could expect no capital gains if the Nikkei were to drop below 15,000.[2] Asked when the company might consider selling stock in a member of its corporate grouping, only 1.7 percent of the respondents said they would at a time when the stock's market value was less than its book value. If holding the stock became too costly for any unspecified business reason, then 19.1 percent of those surveyed said they would sell. More than half (58 percent) said they would not maintain their cross-shareholdings if business relationships stopped being mutually beneficial. If a business partner sold the company's stock, then 42 percent of the companies responding might similarly sell the partner's stock.

This survey confirmed that pure economic reasons rarely underpin cross-stockholding in Japan. But the survey also indicated that in today's economic environment financial pressures might induce some companies to sell their shares in affiliated *keiretsu* firms. If these companies do act, affected group members most likely would retaliate by selling their corresponding shares, producing a possible domino effect. To reduce the likelihood of this outcome the Ministry of Finance announced in mid-August that public corporations would be allowed to defer reporting stock portfolio losses until the end of the fiscal year next March (see *JEI Report* No. 33B, August 28, 1992). This emergency move, Tokyo hoped, would reduce the pressure on banks and other financial institutions to sell stock to improve their upcoming half-year financial reports.

New Approach to Corporate Governance

A series of scandals has rocked Japanese financial markets over the last five years or so, including client compensation for stock trading losses by brokers, manipulation of stock prices and insider trading. In an effort to mend the damaged image of Japanese business Keidanren (Japan Federation of Economic Organizations) unveiled a set of guidelines for corporate ethics in September

1991. The guidelines stress the responsibility of corporate executives for upholding ethical standards and complying with laws and regulations, as well as the need for fairness in corporate behavior, especially with regard to shareholders, consumers and other community members. The document also calls for institutional reform, including strengthened in-house oversight of corporate management.[3] With these guidelines in mind, Japanese businesses have started to review their corporate governance, including the role of directors, auditors and shareholders.

Directors - As in the United States, company directors are elected at shareholders' meetings in Japan, but the similarities end almost there. Outside directors are well-represented on the boards of many U.S. corporations, particularly Fortune 500 companies. Their presence reflects in part the listing standards of the New York Stock Exchange and other major U.S. exchanges or the National Association of Securities Dealers for the NASDAQ (National Association of Securities Dealers Automated Quotation System) market. NASD, for example, requires that at least two directors be selected from outside the company.[4] If member firms do not meet this standard, their stock automatically is delisted from the NASDAQ market, a fairly strict means of enforcement. The NYSE has the same trading requirement. Dale M. Hanson, chief executive officer of the California Public Employees' Retirement System, the biggest U.S. institutional investor, has said, "Directors should have the ability to effectively direct, oversee and evaluate the company's management. ... CalPERS strongly encourages distinguished or independent directors."[5]

Independent directors are rarely found on the boards of public corporations in Japan, even in major companies that sometimes have more than 50 directors. Occasionally, a few outsiders serve as full- or part-time directors but, unlike the business executives, lawyers and academics who are elected to boards in the United States, they usually serve concurrently as directors of companies in the same *keiretsu* or on the boards of the firm's main bank. Moreover, their oversight role and decisionmaking influence are relatively limited — unless the company gets into financial trouble.

Since major nonbank firms in Japan rely on bank loans for a significant portion of their financing (see Table 3), Japanese bankers, particularly those affiliated with the company's lead bank,

Table 3: **Sources of Financing of Major Nonbank Firms in Japan and the United States, 1970-89**

(net flow basis; share)

	1970-74	1975-79	1980-84	1985-89
Japan				
Internal Sources	41.6%	50.6%	59.0%	52.3%
External Sources	58.4	49.4	41.0	47.7
Loans	50.0	41.5	35.0	32.1
Stocks and Bonds	5.7	7.5	6.2	11.0
Other*	2.7	0.4	-0.2	4.6
United States				
Internal Sources	55.1%	69.7%	74.2%	85.4%
External Sources	44.9	30.3	25.8	14.6
Loans	25.6	16.3	15.5	14.0
Stocks and Bonds	18.0	14.0	9.5	-1.3
Other*	1.3	0.0	0.8	1.9

*Including overseas financing.

Source: Bank of Japan

have a keen interest in monitoring the company's day-to-day financial status. In times of shaky financial conditions the main bank no longer acts as a silent business partner but exercises much more power.[6] If a company is on the verge of bankruptcy, its main bank in consultation with government officials proposes a restructuring plan, which sometimes includes a change of executives. (Since corporate governance in Japan reinforces the authority of company presidents or chairmen, who have most of the decisionmaking authority — including decisions on personnel matters, the removal of a chief executive by a board of directors gets considerable play in the Japanese media.) In general, though, banks' influence in corporate governance declined in the second half of the 1980s, as large Japanese firms further reduced their dependence on bank borrowing and raised more money by selling stock or issuing convertible and warrant bonds.

Auditors - More thorough auditing might have prevented some of the financial problems now confronting Japanese companies, including money-losing investments made in the late 1980s when the cost of capital was extremely low and profitability of little concern. By law auditors are selected at shareholders' meetings. In most companies in Japan, however, these jobs are considered honorary positions reserved for retired directors of the firm. NYSE and NASD listing standards, in contrast, require companies to form an audit committee made up entirely or primarily of independent directors.

In a position paper released this past March Keidanren suggested that corporate boards strengthen the role of inside auditors by appointing former chief executives of the company or by extending the ~~terms of~~ auditors to make them more independent.[7] Many Japanese business leaders consider the election of true outside directors and auditors to be too radical a move for the time being. Yet some analysts expect that, sooner or later, Japanese stockholders will push for the inclusion of independent directors and auditors to ensure that shareholders' interests are protected.

Shareholders - Whether individuals or big institutional investors, shareholders have even less say in how public companies in Japan are run. In fact, Japanese corporate executives' abilities often are assessed by how quickly they conduct the annual shareholders' meeting. The best managers supposedly end the meeting as soon as they can without any disturbance (typically in under 30 minutes). The Commercial Law prescribes the issues that must be approved by stockholders, including the selection of directors and auditors and their compensation, the company's financial statement and the allocation of aftertax corporate income. Since debate gives the public a bad impression of management's skills, corporate executives worry about opposing views. Organized protest groups known as *sokaiya* — which in many cases are affiliated with gangsters or *yakuza* — used to take advantage of shareholders' meetings to threaten managers (see *JEI Report* No. 18A, May 8, 1992). In an effort to prevent *sokaiya* activity most major companies hold their annual meetings on the same day. Under these circumstances it is unusual for shareholders, particularly individual owners, to express their views at the meetings.

Government - In the wake of public criticism last year against what was perceived as government negligence in handling disclosures of unethical or improper activities by Japanese brokerage houses and banks, Tokyo has shown more interest in protecting shareholders' rights and strengthening oversight of the securities and banking industries. Various analysts have pointed out the conflicting roles played by the government as promoter and protector of industry as well as its regulator. The Ministry of Finance, for example, traditionally has been responsible for supervising the securities market, but it also promotes the activities of brokers through regulations and administrative guidance. To address the conflict inherent in this dual role, MOF recently established the Securities and Exchanges Surveillance Commission to police stock trading (see *JEI Report* No. 29B, July 31, 1992).

Outside Influence - American investors owning stock in Japanese companies also are calling for changes in corporate governance. They want to see improvements in such areas as disclosure of financial information and the way in which shareholders' meetings are run. Pushed by T. Boone Pickens, who failed to win a director's seat despite being the major shareholder in Koito Manufacturing Co., Ltd. (see *JEI Report* No. 38B, September 29, 1989), U.S. trade officials participating in the 1989-90 Structural Impediments Initiative talks included on their list of necessary changes in Japan protection of minority stockholders' rights and more extensive disclosure of corporate financial information. In the second annual follow-up report on the SII talks, released in late July (see *JEI Report* No. 30B, August 7, 1992), Tokyo noted that the Legislative Council, which is looking into ways to enhance shareholders' rights, has been examining "such specific issues as improving shareholders' access to corporate financial books and records by relaxing share requirements ... and facilitating derivative lawsuits."[8] Tokyo also said that it expected Japanese companies to give "careful consideration to avoid[ing] possible obstacles to the exercise of shareholders' voting rights by foreign shareholders."[9] Japanese investors, too, support the idea of expanding shareholders' rights, especially with the steep drop in stock prices.

New Thinking on Stock Ownership

Although the United States and many other industrial countries give corporations broad permission to buy back shares in their company from stockholders and hold that stock, such flexibility is missing in Japan. In each of the following situations firms that acquire their own shares have to dispose of the stock almost immediately:

- Firms can acquire their own stock as a way of decreasing their capital.
- Firms temporarily are allowed to hold their own shares after mergers with companies in which they hold shares. For example, if company A merges with company B, which owns stock in company A, or vice versa, the resulting venture can hold its own stock briefly.
- Company C, which has claims on company D's assets, can get back its own stock held by company D if company D fails to repay the debt and has no valuable assets other than the stock.

Japanese businessmen cite several advantages to a company being able to hold its own shares indefinitely.[10] First of all, company ownership of its own stock limits the number of recipients of dividends, thus increasing the payout per share. Moreover, firms with surplus cash can use this money to buy their own shares rather than invest it in possibly unprofitable ventures; in the process they give a boost to the price of their stock. In addition, if Japanese companies were able to own their own shares, they could introduce stock options for executives plus employee stock benefits that are popular in the United States. Stock options, it is argued, would encourage corporate managers to limit their drive for market share at the expense of profits and to be more responsive to shareholders' interests since they would have a financial stake in the company's performance. Finally, self-ownership can provide an alternative to the mutual shareholding practice now employed by Japanese companies. This option often is used in the United States to defend against hostile takeover bids. If it were available in Japan, public corporations would have one less reason to ask other companies to hold a large proportion of their shares without the expectation of economic benefits through dividends or share-price appreciation.

In response to corporate Japan's urging the ruling Liberal Democratic Party this past June suggested that the Commercial Law be amended to give companies more leeway to hold their own shares. The party, however, cited a need to retain certain limitations on this practice. The Legislative Council now is studying the issue.

Conclusion

The Japanese style of corporate management often is characterized as being based on a long-term perspective. Since the majority of shareholders in many Japanese firms consist of friendly institutional investors, managers have a rather free hand. These investors make few demands even though the return on their investments in terms of dividends is relatively small. A stable base of stockholders that rarely rocks the boat gives corporate executives the freedom to invest in various ventures without the need for quick returns. While such a management style is sometimes claimed to contribute to the competitiveness of the Japanese economy, it looks somewhat protected or insulated in the view of U.S. executives, who have to answer to the more insistent demands of shareholders.

The current slump in the Japanese economy and the accompanying pressure on stock prices have prompted institutional investors and corporate executives in Japan to review their relationships with one another. Major stockholders are pushing for higher dividends and the disclosure of more information related to corporate management. This campaign, however low-key in American eyes, indicates that Japanese corporate executives no longer have the complete management flexibility they once enjoyed. Signs of change still are sporadic, but there are indications that Japanese corporate management is moving in the direction of the American version. This shift may weaken the competitiveness of Japanese companies in the short run. But through the process of change Japanese business practices will become more transparent and easier for domestic and foreign business partners to understand. In this sense change is inevitable if the economic systems of Japan and other countries are to be harmonized.

For further information, contact **Tadashi Saito**.

Notes

[1] "Haito Seiko No Kaizen Hitsuyo (Necessity of improving the rate of profit return)," *Nihon Keizai Shimbun*, June 29, 1992, p. 7.

[2] "Special Report on Corporate Governance," *Nikkei Business*, June 15, 1992, pp. 10-27.

[3] Keidanren, *Keidanren Kigyo Kodo Kensho (Keidanren Charter for Good Corporate Behavior)* (Tokyo: September 24, 1991).

[4] Interview with David Compton, associate director, NASDAQ Stock Market, and John Pilcher, attorney, Office of General Counsel, National Association of Securities Dealers, Washington, D.C., April 24, 1992.

[5] Dale M. Hanson, "What Does CalPERS Want?," *The Corporate Board*, September/October 1991, p. 3.

[6] Masahiko Aoki, "Toward an Economic Model of the Japanese Firms," *Journal of Economic Literature*, XXVIII, March 1990, pp. 1-27.

[7] Keidanren, *Kaisha Hosei No Arikata Nituiteno Keikai (Statement on Ideal Corporate Legislation)* (Tokyo: March 10, 1992).

[8] *Second Annual Report of SII Follow-up*, July 30, 1992.

[9] *Ibid.*

[10] Shoken Dantai Kyogikai, *Jiko Kabushiki Shutoku Nitsuite (A Study on Holding Own Company's Stock)* (Tokyo: July 7, 1992), pp. 43-47.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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REPORT

A Two-Part Report: A and B

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STATISTICAL PROFILE

JAPAN'S ECONOMY IN 1991
AND
INTERNATIONAL TRANSACTIONS OF JAPAN AND THE UNITED STATES IN 1991

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Table 1: Japan's Gross National Product at 1985 Constant Prices, 1987-1991

(in billions of yen, seasonally adjusted, quarterly figures at annual rates)

	1987	1988	1989	1990	1991
Gross National Product	Y344,332.7 (4.3%)	Y365,823.4 (6.2%)	Y383,447.5 (4.8%)	Y403,371.7 (5.2%)	Y421,274.3 (4.4%)
Personal Consumption Spending	203,335.9 (4.2%)	213,983.1 (5.2%)	223,174.1 (4.3%)	232,581.5 (4.2%)	238,747.6 (2.7%)
Private Residential Construction	19,348.6 (22.6%)	21,643.9 (11.9%)	21,742.0 (0.5%)	22,751.4 (4.6%)	20,939.3 (-8.0%)
Private Fixed Nonresidential Investment	57,653.7 (6.7%)	66,167.1 (14.8%)	77,127.7 (16.6%)	86,659.8 (12.4%)	91,888.0 (6.0%)
Change in Business Inventories	824.9 (-31.1%)	3,218.5 (290.2%)	3,779.6 (17.4%)	2,701.9 (-28.5%)	3,186.9 (18.0%)
Government Current Expenditures	32,124.0 (0.4%)	32,815.3 (2.2%)	33,482.3 (2.0%)	34,116.0 (1.9%)	35,263.3 (3.4%)
Government Fixed Investment	24,091.4 (7.3%)	25,335.7 (5.2%)	24,773.9 (-2.2%)	25,920.8 (4.6%)	27,144.4 (4.7%)
Change in Government Inventories	50.8 (*)	-239.7 (*)	-87.5 (*)	86.2 (*)	-206.5 (*)
Net External Sector	6,903.4 (-22.5%)	2,899.5 (-58.0%)	-544.7 (*)	-1,445.9 (*)	4,311.2 (*)
Exports of Goods and Services and Factor Income Received	51,668.2 (4.6%)	57,212.6 (10.7%)	65,760.2 (14.9%)	72,810.0 (10.7%)	76,504.5 (5.1%)
Imports of Goods and Services and Factor Income Paid	44,764.8 (10.5%)	54,313.1 (21.3%)	66,304.9 (22.1%)	74,255.9 (12.0%)	72,193.3 (-2.8%)

(continued)

Table 1: Japan's Gross National Product at 1985 Constant Prices, 1987-1991 (continued)

(in billions of yen, seasonally adjusted, quarterly figures at annual rates)

	January-March 1990	April-June 1990	July-September 1990	October-December 1990	January-March 1991	April-June 1991	July-September 1991	October-December 1991
Gross National Product	Y394,893.2 (3.5%)	Y402,980.2 (8.5%)	Y405,800.0 (2.8%)	Y409,798.1 (4.0%)	Y418,093.0 (8.4%)	Y421,003.9 (2.8%)	Y423,052.8 (2.0%)	Y422,715.7 (-0.3%)
Personal Consumption Spending	228,828.5 (0.8%)	233,839.3 (9.1%)	234,006.9 (0.3%)	233,610.0 (0.7%)	234,948.3 (2.3%)	238,652.2 (6.5%)	240,449.8 (3.1%)	240,692.7 (0.4%)
Private Residential Construction	22,172.3 (8.8%)	22,379.6 (3.8%)	23,380.4 (19.1%)	22,998.0 (-6.4%)	22,576.7 (-7.1%)	21,110.7 (-23.5%)	20,620.8 (-9.0%)	19,621.3 (-18.0%)
Private Fixed Nonresidential Investment	83,174.1 (11.2%)	85,314.3 (10.7%)	87,558.4 (10.9%)	90,253.3 (12.9%)	92,263.4 (9.2%)	91,559.7 (-3.0%)	92,225.3 (2.9%)	91,491.3 (-3.1%)
Change in Business Inventories	2,203.2 (*)	2,886.9 (*)	3,016.6 (*)	2,666.1 (*)	3,071.8 (*)	3,172.3 (*)	3,420.9 (*)	3,075.5 (*)
Government Current Expenditures	33,827.3 (4.0%)	34,218.4 (4.7%)	33,906.3 (-3.6%)	34,518.7 (7.4%)	35,036.8 (6.1%)	35,595.7 (6.5%)	35,114.8 (-5.3%)	35,297.1 (2.1%)
Government Fixed Investment	25,473.9 (7.1%)	27,229.6 (30.6%)	25,648.6 (-21.3%)	25,981.2 (5.3%)	26,143.3 (2.5%)	27,378.4 (20.3%)	27,392.6 (0.2%)	27,655.8 (3.9%)
Change in Government Inventories	93.7 (*)	292.0 (*)	595.9 (*)	-601.7 (*)	80.2 (*)	-199.8 (*)	240.8 (*)	-942.6 (*)
Net External Sector	-879.8 (*)	-3,180.0 (*)	-2,313.2 (*)	372.4 (*)	3,972.5 (*)	3,734.7 (*)	3,587.8 (*)	5,824.6 (*)
Exports of Goods and Services and Factor Income Received	72,834.5 (23.0%)	73,390.8 (3.1%)	71,547.1 (-9.7%)	73,445.5 (11.0%)	76,508.5 (17.8%)	74,796.4 (-8.7%)	76,671.6 (10.4%)	77,949.8 (6.8%)
Imports of Goods and Services and Factor Income Paid	73,714.3 (16.6%)	76,570.8 (16.4%)	73,860.3 (-13.4%)	73,073.1 (-4.2%)	72,536.0 (-2.9%)	71,061.7 (-7.9%)	73,083.8 (11.9%)	72,125.2 (-5.1%)

*Cannot be calculated or meaningless.

Source: Economic Planning Agency

Table 2: Major Interest Rates in Japan, 1987-1991

(percent per annum)

	Central Bank Discount Rate*	Long-Term Prime Lending Rate*	Call Rate**	Average Interest Rate on Loans and Discounts of All Banks*	Savings Deposits*				Average Interest Rate on Certificates of Deposit*
					Commercial Banks		Post Office		
					Ordinary Deposits	Six-Month Time Deposits	Ordinary Deposits	One-Year Savings Certificates	
1987	2.5%	5.7%	3.51%	4.94%	0.26%	2.64%	1.68%	2.26%	4.53%
1988	2.5	5.7	3.62	4.93	0.26	2.64	1.68	2.26	4.48
1989	4.25	6.5	4.87	5.78	0.50	3.57	1.92	2.82	6.65
1990	6.0	8.1	7.24	7.70	2.08	5.33	3.48	4.58	8.28
1991	4.5	6.9	7.46	6.99	1.50	4.50	2.88	3.75	6.08

*End of period.
**Average for period.

Source: Bank of Japan

Table 3: Money Supply in Japan, 1987-1991

(in billions of yen, average for period)

	Outstanding Money Supply (M2+CDs)*	Change
1987	¥354,036	10.4%
1988	393,667	11.2
1989	432,671	9.9
1990	483,119	11.7
1991	500,682	3.6

*Includes currency in circulation, demand deposits and time deposits (excluding trust accounts) held by commercial banks, plus certificates of deposit.

Source: Bank of Japan

Table 4: Japan's General Account Expenditures (Revised), FY 1987-FY 1991*

(in billions of yen and percent change)

	FY 1987		FY 1988		FY 1989		FY 1990		FY 1991	
Total Expenditures	Y58,214.2	8.2%	Y61,851.7	6.3%	Y66,311.9	7.2%	Y69,651.2	5.0%	Y70,613.5	1.6%
Social Security	10,321.8	2.3	11,801.4	14.3	12,474.2	5.7	11,564.6	-7.5	12,195.7	5.6
Public Assistance	1,105.2	-0.5	1,062.0	-3.9	1,080.6	1.8	1,050.8	-2.8	1,018.2	-3.1
Social Welfare	2,033.2	2.8	2,146.3	5.6	2,307.7	7.5	2,446.8	6.0	2,634.0	7.7
Social Insurance	6,310.2	2.8	7,732.3	22.5	8,206.4	6.1	7,204.8	-12.2	7,645.9	6.1
Health Services	512.3	3.0	500.7	-2.3	525.4	4.9	561.8	6.9	600.5	6.9
Unemployment Compensation	361.0	-1.8	360.2	-1.2	354.1	-1.7	280.5	-20.8	297.1	5.9
Education and Science	5,063.7	3.6	4,982.0	-1.6	5,075.3	1.9	5,359.4	5.6	5,562.7	3.8
Compulsory Education	2,392.9	-0.9	2,463.5	3.0	2,475.5	0.5	2,642.6	6.7	2,768.4	4.8
Transfer to School Account	1,180.1	8.9	1,124.4	-4.7	1,184.8	5.4	1,264.3	6.7	1,304.8	3.2
Science and Technology Promotion	473.5	24.0	426.6	-9.9	453.9	6.4	474.2	4.5	499.1	5.3
School Facilities	354.6	1.3	283.3	-20.1	262.7	-7.3	244.3	-7.0	254.4	4.1
School Aid	580.9	0.9	601.0	3.5	615.4	2.4	650.3	5.7	649.5	-0.1
Student Loans	81.7	1.5	83.3	2.0	83.0	-0.4	83.7	0.9	86.6	3.4
Public Works	7,428.0	6.9	6,683.0	-10.0	7,398.9	10.7	7,013.2	-5.2	7,343.4	4.7
Erosion and Flood Control	1,221.9	10.9	1,059.4	-13.3	1,080.3	2.0	1,087.3	0.6	1,147.3	5.5
Road Improvement	1,983.8	8.6	1,744.1	-12.1	1,782.3	2.2	1,789.2	0.4	1,900.2	6.2
Harbors and Airports	563.7	9.0	497.1	-12.8	511.5	2.9	515.0	0.7	545.0	5.8
Housing	964.4	2.6	930.3	-3.5	1,539.2	65.5	930.9	-39.5	974.7	4.7
Social Infrastructure	1,106.1	11.8	942.6	-14.8	954.8	1.3	957.4	0.3	1,034.5	8.1
Agricultural Infrastructure	963.7	8.7	852.4	-11.5	867.8	1.8	870.4	0.3	910.2	4.6
Forestry and Industrial Water Supplies	181.2	6.3	163.0	-10.0	160.2	-1.7	157.8	-1.5	165.8	5.1
Disaster Reconstruction	431.6	-14.3	483.8	12.1	492.3	1.8	694.7	41.1	654.6	-5.8
Reserves	11.8	3.6	10.4	-11.9	10.6	1.9	10.6	0.3	11.2	5.3
Pensions	1,895.6	2.5	1,879.8	-0.8	1,855.7	-1.3	1,837.4	-1.0	1,808.3	-1.6
Civil Servants	122.2	0.7	118.1	-3.4	111.8	-5.3	107.8	-3.6	104.7	-2.9
Veterans	1,606.9	2.8	1,599.0	-0.5	1,588.5	-0.7	1,580.5	-0.5	1,560.8	-1.2
Other Pensions	157.6	1.1	154.4	-2.0	147.4	-4.5	141.0	-4.3	134.6	-4.5
Administrative Costs	8.9	-14.3	8.4	-5.6	8.0	-4.8	8.0	-0.2	8.1	1.4
Local Allocation Tax	11,086.2	13.9	13,031.2	17.5	14,964.7	14.8	15,930.8	6.5	15,800.2	-0.8
National Debt Service	11,851.4	11.1	12,030.7	1.5	12,089.8	0.5	14,449.3	19.5	15,536.6	7.5
Defense	3,507.8	5.1	3,728.3	6.3	3,969.9	6.5	4,254.1	7.2	4,440.0	4.4
Economic Cooperation	661.3	10.1	714.4	8.0	750.6	5.1	802.1	6.9	864.8	7.8
Small Business Assistance	263.2	16.6	257.6	-2.1	240.5	-6.6	240.9	0.1	214.6	-10.9
Energy Support	496.8	-12.9	458.4	-7.7	546.1	19.1	547.1	0.2	589.3	7.7
Food Agency Account	688.2	12.1	480.4	-30.2	459.2	-4.4	404.6	-11.9	381.5	-5.7
Miscellaneous	4,292.2	4.6	4 304.6	0.3	4,987.1	15.9	5,642.8	13.1	4,426.5	-21.5
Reserves	200.0	0.0	200.0	0.0	200.0	0.0	325.0	62.5	150.0	-53.8
Industrial Investment Special Account	458.0	100.0	1,300.0	183.8	1,300.0	0.0	1,300.0	0.0	1,300.0	0.0

*Revised budget figures include the supplementary budget.

Source: Ministry of Finance

Table 5: Japan's Discretionary General Account Spending (Revised), FY 1987-FY 1991*

(in billions of yen and percent change)

	FY 1987		FY 1988		FY 1989		FY 1990		FY 1991	
Total Expenditures	Y58,214.2	8.2%	Y61,851.7	6.3%	Y66,311.9	7.2%	Y69,651.2	5.0%	Y70,613.5	1.4%
Minus										
Debt Service and Transfers to Local Governments	22,937.6	12.4	25,061.9	9.3	27,054.5	8.0	30,380.1	12.3	31,336.8	3.2
Equals										
Discretionary Spending	35,276.5	5.5	36,789.8	4.3	39,257.4	6.7	39,271.0	0.0	39,276.7	0.0

*Revised budget figures include the supplementary budget.

Source: Ministry of Finance

Table 6: Japan's General Account Revenues (Revised), FY 1987-FY 1991*

(in billions of yen and percent change)

	FY 1987		FY 1988		FY 1989		FY 1990		FY 1991	
Total Revenues	Y58,214.2	8.2%	Y61,851.7	6.3%	Y66,311.9	7.2%	Y69,651.2	5.0%	Y70,613.5	1.4%
Tax and Stamp Revenues	43,087.0	9.3	48,106.0	11.7	54,227.0	12.7	59,131.0	9.0	58,990.0	-0.2
Direct Taxes	31,703.0	7.6	36,284.0	14.5	41,541.0	14.5	44,842.0	7.9	45,242.0	0.9
Income Taxes	16,188.0	-1.3	16,928.0	4.6	20,057.0	18.5	24,345.0	21.4	25,738.0	5.7
Corporate Taxes	13,722.0	17.0	17,712.0	29.1	19,577.0	10.5	18,637.0	-4.8	17,458.0	-6.3
Inheritance and Gift Taxes	1,793.0	32.7	1,644.0	-8.3	1,907.0	16.0	1,860.0	-2.5	2,046.0	10.0
Indirect Taxes and Stamp Revenues	11,384.0	14.2	11,822.0	3.9	12,686.0	7.3	14,289.0	12.6	13,748.0	-3.8
Liquor Taxes	2,042.0	3.4	2,066.0	1.2	1,801.0	-12.8	1,914.0	6.3	2,000.0	4.5
Gasoline Taxes	1,596.0	1.5	1,314.0	-17.7	1,365.0	3.9	1,423.0	4.2	1,503.0	5.6
Consumption Tax	n.a.	n.a.	n.a.	n.a.	3,618.0	100.0	4,870.0	34.6	4,944.0	1.5
Commodity Taxes	1,686.0	3.6	1,864.0	10.6	0.0	-100.0	0.0	0.0	0.0	0.0
Securities Transaction Tax	1,766.0	80.0	1,800.0	1.9	1,234.0	-31.4	1,020.0	-17.3	492.0	-51.8
Stamp Revenues	1,806.0	23.5	1,973.0	9.2	1,849.0	-6.3	2,026.0	9.6	1,703.0	-15.9
Monopoly Profits	6.0	-21.1	8.0	34.2	7.7	-3.8	8.3	7.8	8.6	3.9
Public Enterprise Receipts	17.5	4.8	16.7	-5.0	16.9	1.7	17.6	3.6	19.1	8.5
Sale of Public Properties	180.6	34.3	126.1	-30.2	173.3	37.5	128.5	-25.9	127.2	-0.9
Miscellaneous	2,044.7	-10.7	2,653.5	29.8	2,385.4	-10.1	2,505.3	5.0	3,234.7	29.1
Public Bonds	10,539.0	-8.3	7,967.0	-24.4	7,111.0	-10.7	7,312.0	2.8	6,730.0	-8.0
Carryover Surplus	2,339.4	430.1	2,974.6	27.2	2,390.6	-19.6	548.6	-77.1	1,503.9	174.2

*Revised budget figures include the supplementary budget.

Source: Ministry of Finance

Table 7: Uses and Sources of Japan's Fiscal Investment and Loan Program Outlays (Initial), FY 1987-FY 1991

(in billions of yen and percent change)

	FY 1987		FY 1988		FY 1989		FY 1990		FY 1991	
Total Outlays	Y27,081.3	7.1%	Y29,614.0	9.4%	Y32,270.5	9.0%	Y34,572.4	7.1%	Y36,805.6	6.5%
Housing	6,328.2	8.1	6,921.5	9.4	7,460.6	7.8	8,365.9	12.1	9,474.5	13.3
Other Social Infrastructure	3,998.7	8.2	4,450.9	11.3	4,371.3	-1.8	4,222.0	-3.4	4,293.3	1.7
Welfare	627.7	0.3	661.8	5.4	736.0	11.2	851.9	15.7	1,026.1	20.4
Education	784.1	15.6	637.6	-18.7	520.2	-18.4	554.1	6.5	582.4	5.1
Small Business	3,985.6	7.7	4,030.6	1.1	4,176.4	3.6	4,337.8	3.9	4,494.5	3.6
Agriculture	907.8	0.6	979.4	7.9	924.4	-5.6	876.0	-5.2	908.2	3.7
Land Conservation and Disaster Work	493.0	16.6	409.8	-16.9	357.9	-12.7	328.5	-8.2	330.6	0.6
Roads	2,363.0	16.7	2,512.1	6.3	2,576.8	2.6	2,700.1	4.8	2,983.2	10.5
Transportation and Communications	2,264.1	12.4	2,229.9	-1.5	2,361.6	5.9	2,304.1	-2.4	1,468.1	-36.3
Regional Development	657.7	16.2	552.2	-0.8	676.6	3.7	682.5	0.9	709.0	3.9
Industry and Technology	630.9	-0.8	687.2	8.9	758.7	10.4	796.5	5.0	937.7	17.7
Foreign Trade and Economic Cooperation	690.5	-33.2	1,171.0	69.6	1,420.0	21.3	1,603.0	12.9	1,898.0	18.4
Cash Management	3,350.0	n.a.	4,270.0	27.5	5,930.0	38.9	6,950.0	17.2	7,700.0	10.8
Total Revenues	Y31,081.3	14.5%	Y33,114.0	6.5%	Y34,570.5	4.4%	Y36,572.4	5.8%	Y37,405.6	2.3%
Industrial Investment Special Account	144.3	134.6	91.2	-36.8	85.2	-6.6	64.1	-24.8	65.7	2.5
Trust Fund Bureau Fund	24,595.8	18.6	26,206.6	6.6	26,871.3	2.5	28,453.3	5.9	29,134.9	2.4
Postal Savings	7,900.0	12.9	7,900.0	0.0	8,500.0	7.6	7,200.0	-15.3	8,800.0	22.2
Pension Contributions	4,450.0	3.5	3,500.0	-21.3	4,310.0	23.1	5,540.0	28.5	6,430.0	16.1
Other Revenues	12,245.8	29.7	14,806.6	20.9	14,061.3	-5.0	15,713.3	11.7	13,904.9	-11.5
Postal Life Insurance Fund	3,941.2	25.3	4,409.4	11.9	5,614.0	27.3	6,055.0	7.9	6,305.0	4.1
Government-Guaranteed Bonds and Borrowings	2,400.0	-25.2	2,406.8	0.3	2,000.0	-16.9	2,000.0	0.0	1,900.0	-5.0

Source: Ministry of Finance

Table 8: Japan's Industrial Production Index by Sector, 1987-1991

(1985 = 100)

	Total		Mining	Manufacturing	Steel	Nonferrous Metals	Fabricated Metal Products	Nonelectric Machinery	Electric Machinery	Transport Equipment
	Index	Change								
1987	103.2	3.4%	90.3	103.2	96.3	107.6	103.2	95.9	113.7	96.8
1988	113.0	9.5	85.9	113.1	105.0	114.2	111.0	110.3	132.3	105.5
1989	119.9	6.1	81.8	120.1	106.9	122.1	116.1	122.2	142.1	116.2
1990	125.4	4.6	78.1	125.6	108.8	130.3	120.5	128.1	149.6	125.7
1991	128.0	2.1	81.4	128.3	110.1	134.4	123.2	128.4	159.7	126.1

	Precision Instruments	Nonmetallic Mineral Products	Chemicals	Petroleum and Coal Products	Plastic Products	Pulp, Paper and Paper Products	Textiles	Food and Tobacco Products	Other
1987	105.4	100.3	111.1	92.9	106.7	109.2	94.4	101.9	103.9
1988	114.1	109.6	120.4	96.7	113.3	118.7	94.5	103.6	109.8
1989	120.8	114.0	128.7	101.4	117.7	127.6	93.7	104.7	115.0
1990	136.0	119.2	134.4	110.4	122.5	133.2	90.8	105.3	121.5
1991	143.7	120.3	137.3	117.6	124.2	137.1	89.3	105.9	116.7

Source: Ministry of International Trade and Industry

Table 9: Japan's Index of Industrial Production by End-Use Classification, 1987-1991

(1985 = 100)

	Final Demand Goods					Producer Goods
				Consumer Goods		
	Total	Capital Goods	Construction Materials	Durable	Nondurable	
1987	103.2	102.2	105.5	101.5	104.5	103.1
1988	112.2	116.6	112.0	108.8	109.4	113.9
1989	119.1	128.7	116.5	112.4	113.6	120.9
1990	124.6	135.8	119.3	119.0	117.4	126.4
1991	126.2	138.1	118.9	121.1	117.6	130.1

Source: Ministry of International Trade and Industry

Table 10: Japan's Index of Producers' Inventories of Finished Goods, 1987-1991

(1985 = 100)

	Total	Mining	Manufacturing	Steel	Nonferrous Metals	Fabricated Metal Products	Nonelectric Machinery	Electric Machinery	Transport Equipment
1987	97.4	264.3	96.9	89.4	93.6	100.6	95.4	98.8	92.4
1988	99.0	276.4	98.4	91.6	89.7	103.9	94.4	104.1	90.4
1989	106.8	261.2	106.3	92.3	98.8	110.2	104.1	128.3	98.2
1990	109.3	216.6	108.9	92.2	103.0	112.8	107.3	125.1	92.6
1991	117.3	164.9	117.2	99.3	108.0	118.6	123.8	139.2	104.0

	Precision Instruments	Nonmetallic Mineral Products	Chemicals	Petroleum and Coal Products	Plastic Products	Pulp, Paper and Paper Products	Textiles	Food and Tobacco Products	Other
1987	112.8	98.7	98.2	98.5	99.8	107.2	97.0	95.5	95.9
1988	101.5	96.4	102.3	99.7	104.8	106.4	98.7	93.2	103.7
1989	113.8	99.9	112.8	104.3	112.2	122.8	103.8	86.1	113.1
1990	101.2	104.3	118.7	113.5	112.2	134.0	107.1	91.8	120.1
1991	125.9	110.9	130.0	114.7	119.4	147.5	105.7	91.6	130.3

Source: Ministry of International Trade and Industry

Table 11: Japan's Index of Consumption of Materials, 1987-1991

(1985 = 100)

	Manufacturing	Steel	Non-ferrous Metals	Fabricated Metal Products	Machinery	Nonmetallic Mineral Products	Chemicals	Petroleum and Coal Products	Plastic Products	Pulp, Paper and Paper Products	Textiles	Other Industries
1987	97.6	90.4	104.7	104.9	95.2	102.9	105.7	93.1	108.3	106.9	94.0	101.1
1988	105.4	98.9	111.5	110.2	105.5	111.3	113.7	96.5	116.1	115.0	93.6	104.0
1989	110.6	102.0	115.1	114.6	111.8	115.5	120.9	101.4	121.3	122.7	93.1	106.1
1990	115.9	104.8	121.8	116.5	119.2	119.8	126.0	109.3	126.7	126.7	90.6	106.0
1991	117.3	104.9	125.3	118.2	119.0	120.9	129.8	115.0	126.2	128.7	89.1	103.5

Source: Ministry of International Trade and Industry

Table 12: Japan's Index of Inventories of Materials, 1987-1991

(1985 = 100)

	Manufacturing	Steel	Non-ferrous Metals	Fabricated Metal Products	Machinery	Nonmetallic Mineral Products	Chemicals	Petroleum and Coal Products	Plastic Products	Pulp, Paper and Paper Products	Textiles	Other Industries
1987	91.4	91.8	64.3	88.0	82.6	90.8	100.0	97.0	99.7	90.7	91.6	100.5
1988	94.7	97.3	65.0	91.6	91.1	92.8	100.4	97.9	102.9	96.1	95.9	100.1
1989	95.0	97.8	63.4	93.6	97.2	100.1	105.0	88.6	104.2	102.8	97.1	102.1
1990	97.0	101.9	63.9	94.9	102.6	105.4	105.9	87.8	108.1	104.6	96.5	104.3
1991	99.7	103.3	79.7	96.0	109.5	107.6	113.2	89.3	108.0	103.3	93.2	99.4

Source: Ministry of International Trade and Industry

Table 13: Japan's Index of Manufacturing Operating Rates, 1987-1991

(1985 = 100)

	Total	Steel	Non-ferrous Metals	Fabricated Metal Products	Nonelectric Machinery	Electric Machinery	Transport Equipment	Precision Instruments	Nonmetallic Mineral Products	Chemicals	Petroleum and Coal Products	Pulp, Paper and Paper Products	Textiles
1987	95.5	95.6	104.8	103.4	83.1	90.1	95.0	88.8	95.4	104.3	97.4	109.6	98.2
1988	101.1	105.9	109.1	112.5	94.3	91.6	98.6	93.3	101.6	109.5	104.1	118.6	99.8
1989	103.3	110.4	111.6	119.5	100.1	88.6	102.2	83.7	106.0	111.0	110.6	124.3	100.0
1990	105.7	114.2	114.3	121.8	102.6	92.3	103.2	90.3	111.7	111.8	120.1	127.0	99.7
1991	104.1	114.3	114.3	120.3	96.1	93.1	100.0	91.1	113.5	109.4	125.2	127.5	99.0

Source: Ministry of International Trade and Industry

Table 14: Residential Construction Starts in Japan, 1987-1991

(units)

	Total	Type of Housing		Owner-Occupant Relationship			
		Public	Private	Owner-Built	Developer-Built	Rental Units	Other
1987	1,674,300	80,719	1,593,581	546,316	246,861	858,726	22,397
1988	1,684,644	84,466	1,600,178	508,660	293,311	858,665	24,008
1989	1,662,612	78,674	1,583,938	504,228	312,005	817,186	29,193
1990	1,707,109	78,494	1,628,615	486,527	379,600	806,097	34,885
1991	1,370,126	78,363	1,291,763	440,058	304,479	583,924	41,665

Source: Ministry of Construction

Table 15: Japan's Labor Force Survey, 1987-1991

(in thousands of persons)

	Working-Age Population*	Total Labor Force	Employed Labor Force	Totally Unemployed Labor Force	Unemployment Rate	Not in Labor Force	Ratio of Job Openings to Applications**
1987	97,200	60,840	59,110	1,730	2.8%	35,840	0.70
1988	98,490	61,660	60,110	1,550	2.5	36,350	1.01
1989	99,740	62,700	61,280	1,420	2.3	36,550	1.26
1990	100,890	63,840	62,490	1,340	2.1	36,570	1.40
1991	101,990	65,050	63,690	1,360	2.1	36,490	1.40

*People 15 years old and over.
**Excludes applications by new school graduates but includes those by people seeking part-time work.

Source: Management and Coordination Agency and Ministry of Labor

Table 16: Employment Index of Regular Workers in Japan, 1987-1991*

(1990 = 100)

	Total	Mining	Construction	Manufacturing	Foods and Tobacco	Textiles	Apparel	Lumber and Wood Products	Pulp and Paper Products	Publishing	Chemicals	Petroleum and Coal Products	Nonmetallic Mineral Products	Steel
1987	93.3	125.4	93.2	95.6	94.4	103.6	95.0	101.0	98.2	90.1	98.7	108.2	97.5	105.3
1988	94.7	117.1	95.3	96.2	96.0	101.9	95.8	101.7	98.1	93.6	99.4	103.0	97.0	101.2
1989	97.1	107.7	97.5	97.9	97.7	100.8	98.2	99.4	98.2	96.6	99.5	100.2	97.5	101.0
1990	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1991	103.1	94.4	104.1	102.1	103.5	97.9	99.2	99.1	100.4	103.7	101.7	101.3	101.2	99.1

	Nonferrous Metals	Fabricated Metal Products	Nonelectric Machinery	Electric Machinery	Transport Equipment	Precision Instruments	Utilities	Transportation and Communications	Wholesale and Retail Trade	Finance and Insurance	Real Estate	Services
1987	96.5	91.7	94.1	94.7	93.3	99.5	101.5	97.4	90.4	95.3	82.9	89.5
1988	96.2	94.1	94.4	95.9	92.9	98.4	101.0	97.2	92.7	96.2	86.7	92.2
1989	97.8	97.3	96.9	97.8	96.1	100.1	100.0	98.6	95.7	98.0	92.4	95.8
1990	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1991	102.9	102.8	102.8	102.8	102.8	102.3	101.0	102.4	103.8	101.1	111.4	104.4

*Establishments with 30 or more regular workers.

Source: Ministry of Labor

Table 17: Nominal Wage Index of Regular Workers in Japan, 1987-1991*

(1990 = 100)

	Total	Mining	Construction	Manufacturing	Foods and Tobacco	Textiles	Apparel	Lumber and Wood Products	Pulp and Paper Products	Publishing	Chemicals	Petroleum and Coal Products	Nonmetallic Mineral Products	Steel
1987	88.6	87.5	83.4	85.9	87.0	89.7	84.5	84.7	89.5	96.2	86.6	84.5	87.0	82.3
1988	91.7	89.6	87.6	89.8	88.2	91.9	88.4	88.2	92.2	94.6	90.3	90.0	92.7	86.6
1989	95.5	94.5	93.3	95.0	93.4	96.6	94.8	93.6	99.1	95.3	95.5	95.5	96.4	93.7
1990	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1991	103.6	108.0	106.8	103.6	103.8	103.2	104.1	104.4	103.1	102.2	103.7	105.0	104.7	101.2

	Nonferrous Metals	Fabricated Metal Products	Nonelectric Machinery	Electric Machinery	Transport Equipment	Precision Instruments	Utilities	Transportation and Communications	Wholesale and Retail Trade	Finance and Insurance	Real Estate	Services
1987	85.6	86.3	84.3	84.8	84.9	81.8	87.7	87.7	88.8	94.6	81.5	92.4
1988	89.8	89.9	89.9	88.6	91.1	88.0	90.9	91.9	91.3	97.6	85.1	93.9
1989	93.9	95.9	94.6	94.4	95.3	93.0	95.0	95.6	95.2	99.3	95.9	95.7
1990	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1991	103.0	103.0	104.3	104.0	103.9	101.6	104.2	103.1	103.8	101.4	100.0	103.6

*Establishments with 30 or more regular workers.

Source: Ministry of Labor

Table 18: Average Monthly Wages of Manufacturing Employees in Japan by Industry, 1987-1991

(in thousands of yen)

	Total	Foods and Tobacco	Textiles	Pulp and Paper Products	Chemicals	Nonmetallic Mineral Products	Steel	Nonferrous Metals	Fabricated Metal Products	Nonelectric Machinery	Electric Machinery	Transport Equipment	Precision Instruments
1987	Y313.2	Y259.6	Y224.2	Y331.7	Y419.2	Y308.1	Y385.2	Y354.6	Y302.6	Y340.7	Y296.2	Y352.4	Y292.2
1988	318.7	245.4	227.3	329.5	421.5	325.9	403.9	373.6	312.6	362.7	299.1	369.6	310.5
1989	336.6	256.7	239.2	351.1	443.6	338.1	438.3	389.7	333.6	380.6	318.9	388.7	325.7
1990	352.0	263.0	250.4	349.4	460.0	350.7	467.3	414.6	350.8	399.2	338.5	406.6	349.1
1991	368.0	291.6	255.1	369.9	485.3	369.4	471.1	431.0	356.3	421.9	351.0	421.0	360.7

Note: Includes overtime pay and bonuses.

Source: Ministry of Labor

Table 19: Index of Labor Productivity in Japan, 1987-1991

(1985 = 100)

	Total	Mining	Manufacturing	Foods	Textiles	Lumber and Wood Products	Pulp and Paper Products	Nonmetallic Mineral Products	Rubber Products	Chemicals
1987	107.8	123.8	107.7	100.4	102.5	107.3	113.3	105.6	104.9	113.2
1988	120.2	137.0	120.1	104.6	107.8	112.9	123.5	125.5	112.0	122.2
1989	127.7	141.0	127.6	108.0	109.8	108.7	133.5	133.0	118.3	132.3
1990	133.1	151.3	133.0	105.4	110.2	104.6	139.1	140.9	121.4	140.6
1991	136.2	166.0	136.1	103.6	113.3	105.0	145.0	144.1	121.4	146.9

	Plastic Products	Petroleum and Coal Products	Steel	Nonferrous Metals	Fabricated Metal Products	Nonelectric Machinery	Electric Machinery	Transport Equipment	Precision Instruments
1987	105.6	107.4	107.1	109.1	108.4	102.8	114.5	102.9	118.1
1988	111.9	119.6	121.5	114.6	116.5	119.3	134.5	113.0	138.7
1989	115.0	131.5	128.3	122.3	119.4	132.9	144.7	120.4	148.1
1990	120.7	146.7	133.3	130.4	121.3	135.9	150.5	129.0	167.9
1991	120.7	157.1	137.0	135.6	125.3	135.8	159.2	127.8	176.4

Source: Japan Productivity Center

Table 20: Japan's Consumer Price Index, 1987-1991

(1990 = 100)

	Total		Food	Housing	Utilities	Furniture and Housewares	Clothing	Medical Care	Transportation	Education	Recreation	Miscellaneous
	Index	Change										
1987	94.2	0.1%	93.4	92.3	100.5	99.9	90.4	97.6	98.0	88.7	93.2	97.1
1988	94.9	0.7	94.1	94.2	98.1	99.4	91.4	98.0	97.5	91.6	93.7	97.5
1989	97.0	2.2	96.1	97.0	97.7	9[illegible].9	95.5	99.5	98.6	95.3	96.7	98.9
1990	100.0	3.1	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1991	103.3	3.3	104.8	103.1	102.3	100.8	104.7	100.6	100.7	104.8	102.9	101.9

Source: Management and Coordination Agency

Table 21: Japan's Wholesale Price Index by Industry, 1987-1991

(1985 = 100)

	Total Index	Total Change	Foods	Textiles	Lumber and Wood Products	Pulp, Paper and Paper Products	Chemicals	Plastic Products	Petroleum and Products	Nonmetallic Mineral Products	Steel	Nonferrous Metals
1987	87.5	-3.7%	98.5	90.5	105.0	94.5	85.7	92.1	64.3	96.5	86.9	83.1
1988	86.6	-1.0	97.9	90.3	103.2	95.3	86.1	92.2	60.8	95.8	90.7	90.6
1989	88.8	2.5	99.1	93.0	111.1	98.3	88.0	94.3	63.9	97.9	95.2	96.7
1990	90.6	2.0	101.6	93.8	115.7	98.9	88.2	96.0	73.8	100.6	95.5	94.7
1991	90.8	0.2	105.6	95.0	113.8	100.5	90.2	102.0	74.4	103.9	95.8	84.8

	Metal Products	Nonelectric Machinery	Electric Machinery	Transport Equipment	Precision Instruments	Miscellaneous Manufactures	Agricultural, Forestry and Fishery Products	Mining Products	Utilities
1987	95.6	93.8	84.3	92.6	97.4	95.3	86.7	50.8	89.0
1988	97.7	93.4	80.4	90.8	94.4	95.8	87.2	45.6	84.0
1989	101.5	96.4	79.7	91.9	93.1	99.7	89.8	50.2	81.1
1990	103.9	99.1	77.8	93.2	94.9	102.3	91.4	57.6	80.4
1991	106.1	100.5	75.3	92.3	94.3	103.7	89.0	54.5	80.5

Source: Bank of Japan

Table 22: Japan's Wholesale Price Index by End-Use Classification, 1987-1991

(1985 = 100)

	Domestic Products										Exports			
			Intermediate Goods				Final Goods							
								Consumer Goods						
	Total	Raw Materials	Total	Semi-finished Goods	Construction Materials	Fuels and Energy	Capital Goods	Total	Durables	Nondurables	Total	Semi-finished Goods	Capital Goods	Consumer Goods
1987	88.5	62.4	88.2	87.7	98.7	74.7	95.5	95.7	94.5	96.2	80.6	75.7	85.2	82.7
1988	87.8	59.9	88.2	88.5	100.4	69.9	95.2	93.9	90.9	95.0	78.8	75.9	83.2	78.3
1989	89.8	64.4	90.7	91.2	104.9	69.6	97.6	93.9	86.2	96.8	82.3	81.0	86.6	80.5
1990	91.7	69.6	92.4	92.0	108.6	73.5	99.1	94.9	84.6	98.8	84.0	81.3	89.4	83.0
1991	92.3	65.7	93.4	92.6	111.2	73.6	100.0	96.4	83.5	101.2	81.1	77.2	87.6	80.0

Source: Bank of Japan

Table 23: Japan's Global Balance of Payments, 1987-1991

(in millions of dollars, IMF value basis, seasonally unadjusted)

		Trade Balance	Exports	Imports	Services	Transfers	Current Account Balance	Long-Term Capital	Basic Balance	Short-Term Capital	Errors and Omissions	Overall Balance	Gold and Foreign Exchange Reserves*
1987		$96,386	$224,605	$128,219	$-5,702	$-3,669	$87,015	$-136,532	$-49,517	$23,865	$-3,893	$-29,545	$81,479
1988		95,012	259,765	164,753	-11,263	-4,118	79,631	-130,930	-51,299	19,521	2,796	-28,982	97,662
1989		76,917	269,570	192,653	-15,526	-4,234	57,157	-89,246	-32,089	20,811	-22,008	-33,286	84,895
1990		63,528	280,374	216,846	-22,292	-5,475	35,761	-43,586	-7,825	21,468	-20,877	-7,234	77,053
1991		103,044	306,557	203,513	-17,660	-12,483	72,901	37,057	109,958	-25,758	-7,831	76,369	68,980
1990	January	1,069	18,216	17,147	-1,393	-235	-559	-2,698	-3,257	-1,124	-144	-4,525	82,717
	February	5,352	21,646	16,294	-341	-194	4,817	-7,905	-3,088	4,846	3,458	5,216	80,443
	March	7,972	25,598	17,626	1,033	-958	8,047	-5,483	2,564	4,436	-7,757	-757	73,496
	April	3,976	21,218	17,242	-1,821	-195	1,960	-5,377	-3,417	-12,321	-4,098	-19,836	73,024
	May	2,618	21,162	18,544	-1,140	-79	1,399	-5,607	-4,208	10,023	3,076	8,891	73,557
	June	7,020	23,130	16,110	-2,318	-169	4,533	-8,001	-3,468	5,433	1,043	3,008	73,649
	July	5,323	23,404	18,081	-3,038	-360	1,925	-8,062	-6,137	-3,668	-2,927	-12,732	74,585
	August	4,061	21,941	17,880	-2,941	-270	850	-4,886	-4,036	3,807	79	-150	75,315
	September	7,765	25,155	17,390	-2,066	-1,074	4,625	5,701	10,326	4,257	-3,798	10,785	75,323
	October	5,838	26,087	20,249	-2,725	-419	2,694	7,031	9,725	-4,259	-5,937	-471	76,190
	November	4,432	25,054	20,622	-2,481	-266	1,685	-2,932	-1,247	4,306	2,842	5,901	76,672
	December	8,102	27,763	19,661	-3,061	-1,256	3,785	-5,367	-1,582	5,732	-6,714	-2,564	77,053
1991	January	3,104	21,573	18,469	-2,824	-235	45	-2,879	-2,834	-2,339	-64	-5,237	77,520
	February	7,084	24,365	17,281	-687	-307	6,090	5,913	12,003	-2,910	-508	8,585	77,974
	March	10,541	29,040	18,499	2,591	-9,007	4,125	7,673	11,798	-6,728	-289	4,781	69,894
	April	8,591	23,521	14,930	-335	-269	7,987	1,034	9,021	-6,234	-3,571	-784	67,935
	May	5,470	23,733	18,263	-1,179	-135	4,156	-7,703	-3,547	-330	2,938	-939	68,168
	June	9,291	24,736	15,445	-2,550	-220	6,521	-434	6,087	-3,281	-1,768	1,038	67,892
	July	8,624	25,753	17,129	-2,666	-862	5,096	4,049	9,145	-2,124	-740	6,281	67,521
	August	8,269	24,223	15,954	-2,484	-235	5,550	12,019	17,569	1,713	-134	19,148	66,888
	September	10,852	26,958	16,106	-1,585	-309	8,958	14,775	23,733	-5,541	-2,250	15,942	66,912
	October	10,127	27,646	17,519	-2,852	-329	6,946	-1,621	5,325	1,071	511	6,907	67,189
	November	8,460	26,306	17,846	-1,163	-243	7,054	325	7,379	2,783	2,437	12,599	67,939
	December	12,631	28,703	16,072	-1,926	-332	10,373	3,906	14,279	-1,838	-4,393	8,048	68,980

*End of period.

Note: For capital transactions, credits (+) indicate net inflows and debits (-) indicate net outflows.

Source: Bank of Japan and Ministry of Finance

Table 24: Japan's Balance of Payments with the United States, 1987-1991

(in millions of dollars, IMF value basis)

	1987	1988	1989	1990	1991
Merchandise Trade Balance	$57,117	$52,448	$49,404	$41,869	$43,442
Exports	83,010	89,146	92,741	89,223	90,485
Imports	25,893	36,698	43,337	47,354	47,043
Services Balance	1,021	115	-1,198	-3,387	-2,662
Transportation	-698	-1,132	-1,610	-2,513	-3,261
Travel	-3,106	-5,721	-7,554	-8,301	-8,045
Investment Income	7,300	11,364	14,318	16,257	17,301
Other	-2,475	-4,396	-6,352	-8,830	-8,657
Official	1,751	1,578	1,307	1,068	1,020
Private	-4,226	-5,974	-7,659	-9,898	-9,677
Unilateral Transfers Balance	-1,460	-1,243	-723	-829	-755
Official	-779	-588	-613	-757	-278
Private	-681	-655	-110	-72	-477
Current Account Balance	56,678	51,320	47,483	37,653	40,025
Long-Term Capital (net)	-61,030	-59,260	-53,861	-11,719	-18,358
Direct Investments (net)	-9,018	-19,568	-22,768	-24,986	-15,302
Trade Credits (net)	-489	-1,024	-1,255	-633	314
Loans (net)	-1,663	-2,830	-4,761	-2,783	-2,569
Stocks and Bonds (net)	-48,223	-33,320	-22,074	19,849	1,045
Other (net)	-1,637	-2,518	-3,003	-3,166	-1,846
Basic Balance	-4,352	-7,940	-6,378	25,934	21,667

Note: For long-term capital transactions, credits (+) indicate net inflows and debits (-) indicate net outflows.

Source: Bank of Japan

Table 25: Japan's Exports and Imports in Dollar Terms, 1987-1991

(in millions of dollars, customs clearance basis, seasonally unadjusted)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1987		$229,221	9.6%	$149,515	18.3%	$79,706
1988		264,917	15.6	187,354	25.3	77,563
1989		275,175	3.9	210,847	12.5	64,328
1990		286,948	4.3	234,799	11.4	52,149
1991		314,526	9.6	236,737	0.8	77,789
1990	January	18,669	-3.6	18,349	13.9	319
	February	22,002	-1.7	17,035	12.5	4,968
	March	26,034	-1.7	18,999	-4.4	7,034
	April	21,912	-5.6	18,394	15.5	3,518
	May	21,548	-0.7	18,458	2.9	3,090
	June	23,772	4.8	17,102	-1.8	6,669
	July	23,910	1.9	18,576	6.4	5,334
	August	22,430	2.8	19,008	3.0	3,422
	September	25,850	6.3	18,964	10.7	6,886
	October	26,718	16.1	23,486	27.9	3,232
	November	25,739	16.6	23,500	26.7	2,239
	December	28,366	15.1	22,929	24.3	5,437
1991	January	21,813	16.8	20,902	13.9	911
	February	24,979	13.5	19,916	16.9	5,062
	March	29,546	13.5	21,051	10.8	8,495
	April	24,107	10.0	17,793	-3.3	6,314
	May	24,459	13.5	20,296	10.0	4,163
	June	25,426	7.0	18,194	6.4	7,232
	July	26,609	11.3	20,008	7.7	6,601
	August	24,806	10.6	19,102	0.5	5,704
	September	27,650	7.0	17,987	-5.1	9,662
	October	28,459	6.5	21,257	-9.5	7,202
	November	27,091	5.3	20,678	-12.0	6,413
	December	29,581	4.3	19,552	-14.7	10,029

Source: Ministry of Finance

Table 26: Japan's Exports and Imports in Yen Terms, 1987-1991

(in billions of yen, customs clearance basis, seasonally unadjusted)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1987		Y33,315	-5.6%	Y21,737	0.9%	Y11,578
1988		33,939	1.9	24,006	10.4	9,933
1989		37,823	11.4	28,979	20.7	8,844
1990		41,457	9.6	33,855	16.8	7,602
1991		42,360	2.2	31,900	-5.8	10,460
1990	January	2,699	10.8	2,649	30.9	50
	February	3,190	10.9	2,469	26.8	721
	March	3,876	14.3	2,824	11.0	1,053
	April	3,445	12.3	2,888	37.2	557
	May	3,380	16.3	2,900	20.8	481
	June	3,624	11.6	2,604	4.5	1,020
	July	3,626	9.2	2,823	14.2	803
	August	3,340	9.1	2,830	9.3	509
	September	3,686	4.4	2,711	9.1	975
	October	3,573	8.7	3,143	20.0	430
	November	3,302	4.8	3,015	13.9	287
	December	3,717	4.8	3,001	13.1	716
1991	January	2,951	9.4	2,827	6.7	124
	February	3,271	2.5	2,608	5.7	662
	March	3,962	2.2	2,821	-0.1	1,140
	April	3,316	-3.7	2,450	-15.2	866
	May	3,370	-0.3	2,795	-3.6	575
	June	3,539	-2.4	2,530	-2.9	1,009
	July	3,693	1.9	2,778	-1.6	915
	August	3,398	1.7	2,617	-7.5	781
	September	3,762	2.1	2,451	-9.6	1,312
	October	3,749	4.9	2,800	-10.9	949
	November	3,533	7.0	2,698	-10.5	835
	December	3,817	2.7	2,525	-15.8	1,292

Source: Ministry of Finance

Table 27: Japan's Export and Import Quantum (Volume) Indexes, 1987-1991

(1985 = 100)

		Exports		Imports	
		Index	Change Over Year-Earlier Period	Index	Change Over Year-Earlier Period
1987		99.2	0.4%	119.3	9.0%
1988		103.6	4.4	139.1	16.7
1989		107.9	4.2	150.1	7.9
1990		114.0	5.7	159.1	6.0
1991		116.8	2.5	163.5	2.8
1990	January	88.6	1.5	156.6	8.1
	February	103.8	2.0	142.1	7.6
	March	126.2	4.1	160.7	-5.0
	April	109.6	2.4	159.1	17.9
	May	108.8	8.2	160.7	6.8
	June	118.2	8.1	148.5	1.2
	July	118.3	6.2	162.5	11.2
	August	109.7	4.6	163.9	4.7
	September	121.1	1.9	151.2	3.3
	October	122.4	10.9	171.0	8.9
	November	114.7	9.8	166.1	5.1
	December	126.4	7.8	167.1	5.2
1991	January	97.3	9.8	159.2	1.7
	February	108.3	4.3	154.1	8.4
	March	130.5	3.4	175.7	9.3
	April	107.8	-1.6	145.2	-8.7
	May	111.9	2.8	172.0	7.0
	June	115.8	-2.0	154.5	4.0
	July	121.9	3.0	171.1	5.3
	August	113.7	3.6	163.8	-0.1
	September	122.9	1.5	153.7	1.7
	October	125.7	2.7	178.1	4.2
	November	119.7	4.4	171.6	3.3
	December	126.3	-0.1	163.5	-2.2

Source: Ministry of Finance

Table 28: Japan's Export and Import Yen-Based Price Indexes, 1987-1991

(1985 = 100)

		Exports		Imports	
		Index	Change Over Year-Earlier Period	Index	Change Over Year-Earlier Period
1987		80.6	-5.1%	58.9	-8.3%
1988		78.8	-2.2	56.2	-4.6
1989		82.3	4.4	60.5	7.7
1990		84.0	2.1	65.7	8.6
1991		81.1	-3.5	60.6	-7.8
1990	January	84.2	6.3	62.6	13.0
	February	84.2	6.0	63.4	11.8
	March	86.1	7.4	65.9	14.0
	April	87.9	9.1	67.3	13.3
	May	86.5	5.4	65.8	7.0
	June	86.1	2.3	64.8	3.0
	July	85.2	2.3	63.2	1.9
	August	85.1	2.2	64.0	3.6
	September	82.3	-2.3	66.4	6.1
	October	80.0	-4.0	67.7	9.7
	November	79.8	-4.8	68.4	10.5
	December	81.1	-3.2	69.0	11.5
1991	January	81.6	-3.1	67.7	8.1
	February	80.5	-4.4	64.0	0.9
	March	82.1	-4.6	62.3	-5.5
	April	81.7	-7.1	61.0	-9.4
	May	82.0	-5.2	60.7	-7.8
	June	82.1	-4.6	60.9	-6.0
	July	81.6	-4.2	59.6	-5.7
	August	81.4	-4.3	59.0	-7.8
	September	80.8	-1.8	58.5	-11.9
	October	79.5	-0.6	57.6	-14.9
	November	79.8	0.0	57.8	-15.5
	December	79.6	-1.8	57.5	-16.7

Source: Bank of Japan

Table 29: Yen-Dollar Exchange Rate Used to Convert Customs Clearance Trade Data, 1987-1991*

		Exports	Imports
1987	Average	¥145.90	¥146.01
1988	Average	128.13	128.15
1989	Average	137.36	137.26
1990	Average	145.10	145.09
1991	Average	134.82	134.84
1990	January	144.57	144.36
	February	144.98	144.93
	March	148.90	148.61
	April	157.20	156.99
	May	156.86	157.09
	June	152.45	152.28
	July	151.64	151.95
	August	148.89	148.90
	September	142.59	142.96
	October	133.73	133.82
	November	128.30	128.31
	December	131.03	130.86
1991	January	135.30	135.27
	February	130.93	130.97
	March	134.08	134.02
	April	137.55	137.68
	May	137.79	137.71
	June	139.18	139.05
	July	138.78	138.85
	August	136.98	137.00
	September	136.07	136.24
	October	131.72	131.72
	November	130.42	130.47
	December	129.03	129.14

*Reflects the exchange rate that prevailed at the time export or import contracts were signed.

Source: Ministry of Finance

Table 30: Yen-Dollar Exchange Rate on Tokyo Foreign Exchange Market, 1987-1991

(average for period)

	1987	1988	1989	1990	1991
Average	¥144.64	¥128.15	¥137.96	¥144.79	¥134.71
January	154.48	127.56	127.23	145.09	133.88
February	153.48	129.16	127.77	145.53	130.48
March	151.56	127.28	130.36	153.08	137.20
April	142.98	124.93	132.08	158.47	137.10
May	140.54	124.77	138.35	153.52	138.04
June	144.48	127.14	143.79	153.77	139.79
July	150.21	133.07	140.72	149.28	138.01
August	147.56	133.63	141.11	147.42	138.89
September	143.00	134.44	145.05	138.99	134.58
October	143.54	129.02	141.93	129.73	130.72
November	135.25	123.19	143.52	129.08	129.68
December	128.59	123.63	143.66	133.55	128.11

Source: International Monetary Fund

Table 31: Japan's Exports by Major Market, 1987-1991

(in millions of dollars, f.o.b. value basis)

	1987	1988	1989	1990	1991
Total Exports	$229,221	$264,917	$275,175	$286,948	$314,526
Developed Countries	142,883	161,847	167,358	169,964	176,937
United States	83,580	89,634	93,189	90,322	91,538
Canada	5,611	6,424	6,807	6,727	7,251
Western Europe	45,555	56,023	56,494	63,332	68,940
Denmark	917	792	758	969	916
United Kingdom	8,400	10,632	10,741	10,786	11,040
Netherlands	4,071	5,054	5,112	6,165	7,219
Belgium	2,697	3,390	3,455	3,807	4,190
France	4,014	4,987	5,298	6,128	6,117
West Germany	12,833	15,793	15,920	17,782	20,605
Spain	1,343	1,860	1,942	2,092	2,563
Italy	2,103	2,787	2,783	3,409	3,789
European Community	37,693	46,873	47,908	53,518	59,158
Sweden	1,931	2,320	2,174	1,954	1,796
Switzerland	2,266	2,775	2,664	2,931	3,008
Austria	1,006	1,406	1,327	1,616	1,919
Australia	5,146	6,680	7,805	6,900	6,493
New Zealand	1,128	1,039	1,346	1,206	1,081
South Africa	1,863	2,047	1,717	1,477	1,635
Developing Countries	74,402	89,250	95,173	107,142	125,645
Latin America	8,760	9,297	9,381	10,280	12,794
Mexico	1,389	1,772	1,908	2,271	2,818
Panama	2,416	2,653	2,512	2,893	3,946
Chile	353	368	636	483	631
Brazil	879	998	1,310	1,225	1,226
Southeast Asia	52,982	67,109	73,516	82,721	96,176
South Korea	13,229	15,441	16,561	17,457	20,068
Taiwan	11,346	14,354	15,421	15,430	18,255
Hong Kong	8,872	11,706	11,526	13,072	16,315
Thailand	2,953	5,162	6,838	9,126	9,431
Singapore	6,008	8,311	9,239	10,708	12,213
Malaysia	2,168	3,060	4,124	5,511	7,635
Philippines	1,415	1,740	2,381	2,504	2,659
Indonesia	2,990	3,054	3,301	5,040	5,613
India	1,957	2,082	2,018	1,708	1,523
Middle East and North Africa	9,177	9,438	8,559	9,877	12,313
Iran	1,043	808	922	1,617	2,473
Saudi Arabia	3,239	3,142	2,763	3,341	3,893
Qatar	151	173	211	152	209
Oman	262	348	334	420	613
United Arab Emirates	1,118	1,286	1,296	1,550	2,154
Subsaharan Africa	2,894	2,760	2,892	3,409	3,577
Eastern Europe and Communist Asia	11,924	13,818	12,644	9,842	11,943
China	8,250	9,476	8,516	6,130	8,593
U.S.S.R.	2,563	3,130	3,082	2,563	2,114

Source: Ministry of Finance

Table 32: Japan's Imports by Major Supplier, 1987-1991

(in millions of dollars, c.i.f. value basis)

	1987	1988	1989	1990	1991
Total Imports	$149,515	$187,354	$210,847	$234,799	$236,737
Developed Countries	71,610	94,785	107,313	119,316	116,875
United States	31,491	42,037	48,246	52,369	53,317
Canada	6,073	8,308	8,645	8,392	7,698
Western Europe	22,749	30,578	35,126	42,617	39,209
Denmark	944	1,142	1,199	1,126	1,290
United Kingdom	3,057	4,193	4,466	5,239	5,017
Netherlands	757	996	1,122	1,170	1,227
Belgium	859	1,125	1,430	1,557	1,353
France	2,871	4,315	5,546	7,590	5,813
West Germany	6,150	8,101	8,995	11,487	10,739
Spain	357	537	556	793	674
Italy	2,135	2,895	3,806	5,008	4,534
European Community	17,670	24,071	28,146	35,028	31,792
Sweden	682	977	1,086	1,292	1,272
Switzerland	3,101	3,565	3,863	4,082	3,629
Austria	349	442	521	705	773
Australia	7,869	10,285	11,605	12,369	13,011
New Zealand	1,168	1,644	1,657	1,727	1,819
South Africa	2,259	1,933	2,035	1,843	1,819
Developing Countries	67,277	78,704	87,946	98,502	100,744
Latin America	6,356	8,313	8,871	9,851	9,838
Mexico	1,625	1,591	1,730	1,931	1,742
Panama	69	137	85	111	98
Chile	617	1,023	1,322	1,622	1,888
Brazil	2,032	2,950	2,999	3,173	3,180
Southeast Asia	38,627	47,802	52,906	54,601	58,810
South Korea	8,076	11,811	12,994	11,707	12,339
Taiwan	7,128	8,744	8,979	8,496	9,493
Hong Kong	1,561	2,109	2,219	2,173	2,064
Thailand	1,796	2,751	3,583	4,147	5,252
Singapore	2,048	2,339	2,952	3,571	3,415
Malaysia	4,772	4,710	5,107	5,402	6,471
Philippines	1,353	2,044	2,060	2,157	2,352
Indonesia	8,427	9,497	11,021	12,721	12,770
India	1,530	1,804	1,978	2,075	2,190
Middle East and North Africa	20,197	19,602	23,054	31,336	29,331
Iran	1,556	1,164	1,792	3,460	2,792
Saudi Arabia	7,311	6,348	7,048	10,462	10,081
Qatar	880	1,139	1,546	2,153	2,157
Oman	1,414	1,690	1,530	1,957	2,164
United Arab Emirates	5,408	5,324	6,051	9,085	10,524
Subsaharan Africa	1,435	2,011	2,043	1,877	1,873
Eastern Europe and Communist Asia	10,628	13,863	15,584	16,977	19,115
China	7,401	9,859	11,146	12,054	14,216
U.S.S.R.	2,352	2,766	3,005	3,351	3,317

Source: Ministry of Finance

Table 33: Japan's Trade Balance with Major Trading Partners, 1987-1991

(in millions of dollars; exports f.o.b., imports c.i.f.)

	1987	1988	1989	1990	1991
Overall Balance	$79,706	$77,563	$64,328	$52,149	$77,789
Developed Countries	71,273	67,062	60,045	50,648	60,062
United States	52,090	47,597	44,943	37,954	38,220
Canada	-462	-1,884	-1,838	-1,666	-447
Western Europe	22,806	25,445	21,368	20,715	29,730
Denmark	-27	-350	-441	-156	-374
United Kingdom	5,343	6,439	6,275	5,547	6,023
Netherlands	3,314	4,059	3,991	4,996	5,991
Belgium	1,837	2,265	2,024	2,250	2,836
France	1,143	672	-247	-1,462	304
West Germany	6,682	7,692	6,925	6,295	9,867
Spain	987	1,324	1,385	1,300	1,889
Italy	-32	-108	-1,023	-1,600	-746
European Community	20,024	22,802	19,761	18,490	27,366
Sweden	1,250	1,343	1,088	661	524
Switzerland	-835	-790	-1,199	-1,151	-621
Austria	658	964	806	910	1,146
Australia	-2,723	-3,604	-3,800	-5,469	-6,518
New Zealand	-41	-605	-310	-521	-738
South Africa	-396	114	-318	-366	-185
Developing Countries	7,126	10,546	7,227	8,640	24,901
Latin America	2,405	984	510	429	2,955
Mexico	-236	182	178	340	1,076
Panama	2,348	2,516	2,427	2,782	3,848
Chile	-264	-655	-686	-1,139	-1,257
Brazil	-1,154	-1,952	-1,689	-1,948	-1,954
Southeast Asia	14,355	19,307	20,611	28,120	37,366
South Korea	5,154	3,631	3,567	5,751	7,729
Taiwan	4,218	5,611	6,442	6,934	8,762
Hong Kong	7,312	9,598	9,307	10,899	14,251
Thailand	1,157	2,410	3,256	4,979	4,179
Singapore	3,961	5,972	6,287	7,137	8,799
Malaysia	-2,604	-1,650	-983	110	1,163
Philippines	62	-304	321	347	308
Indonesia	-5,437	-6,443	-7,720	-7,682	-7,157
India	427	277	41	-367	-668
Middle East and North Africa	-11,020	-10,164	-14,496	-21,459	-17,018
Iran	-512	-356	-870	-1,843	-319
Saudi Arabia	-4,072	-3,206	-4,285	-7,120	-6,188
Qatar	-729	-967	-1,335	-2,001	-1,948
Oman	-1,152	-1,342	-1,196	-1,537	-1,551
United Arab Emirates	-4,290	-4,038	-4,755	-7,534	-8,371
Subsaharan Africa	1,459	749	849	1,532	1,704
Eastern Europe and Communist Asia	1,297	-44	-2,940	-7,135	-7,172
China	848	-383	-2,630	-5,924	-5,623
U.S.S.R.	211	364	77	-788	-1,203

Source: Ministry of Finance

Table 34: Japan's Exports by Commodity, 1987-1991

(in millions of dollars, f.o.b. value basis)

	1987	1988	1989	1990	1991
Total Exports	$229,221	$264,917	$275,175	$286,948	$314,526
Food and Live Animals	1,424	1,568	1,547	1,482	1,607
Fish and Fish Products	732	781	747	664	725
Beverages and Tobacco	121	129	140	164	215
Crude Materials (excl. fuels)	1,490	1,761	1,829	1,838	1,901
Rubber	400	472	469	504	523
Textile Fibers and Waste	708	848	827	838	904
Mineral Fuels	782	596	972	1,283	1,322
Petroleum Products	550	359	692	1,100	1,076
Animal and Vegetable Oils and Fats	85	157	83	98	81
Chemicals	11,662	13,964	14,776	15,872	17,475
Chemical Elements and Compounds	4,979	6,000	6,627	6,857	7,432
Organic Chemicals	4,017	4,892	5,440	5,640	6,187
Inorganic Chemicals	941	1,082	1,156	1,188	1,211
Dyeing, Tanning and Coloring Materials	857	1,028	1,108	1,224	1,398
Pharmaceuticals	589	717	768	879	1,090
Plastic Materials	3,406	4,002	3,968	4,386	4,727
Manufactured Goods Classified Mainly by Material	30,126	35,213	35,567	34,486	37,262
Tires and Other Rubber Manufactures	2,240	3,085	3,478	3,572	3,661
Tires and Tubes for Motor Vehicles	1,515	1,780	1,983	1,961	1,961
Paper and Paper Products	1,407	1,586	1,618	2,001	2,172
Textiles (excl. fibers and apparel)	5,545	5,472	5,471	5,793	6,463
Yarn and Thread	1,118	1,108	1,109	1,117	1,199
Woven Fabrics	3,742	3,598	3,572	3,857	4,295
Made-up Articles (excl. clothing)	686	767	790	819	970
Nonmetallic Mineral Manufactures	2,523	2,936	3,053	3,226	3,500
Glass and Glassware	803	940	989	996	1,173
Tableware	556	537	523	529	525
Steel	12,610	15,322	14,789	12,509	13,612
Bars, Rods, Shapes and Sections	1,688	2,027	1,983	1,656	1,688
Plates, Sheets, Coils and Strip	7,552	8,883	9,168	7,449	7,893
Tubes, Pipes and Fittings	2,843	4,190	3,400	3,184	3,822
Nonferrous Metals	1,772	2,142	2,246	2,400	2,350
Copper and Alloys	854	1,083	1,172	1,146	1,194
Aluminum and Alloys	668	622	635	761	720
Metal Manufactures	3,636	4,287	4,542	4,632	5,164
Nails and Industrial Fasteners	519	720	742	785	754
Tools	958	1,183	1,252	1,231	1,548

(continued)

Table 34: Japan's Exports by Commodity, 1987-1991 (continued)

(in millions of dollars, f.o.b. value basis)

	1987	1988	1989	1990	1991
Machinery and Transport Equipment	$149,563	$183,765	$192,134	$201,250	$221,148
Nonelectric Machinery	44,755	56,048	61,085	63,512	69,508
Power Generating Machinery	5,904	6,738	7,454	7,731	8,294
Internal Combustion Engines	4,876	5,939	6,542	6,541	6,855
Agricultural Machinery	1,298	1,006	868	828	820
Tractors	920	696	613	555	535
Office Machinery	14,392	18,406	19,278	20,618	22,250
Data Processing Equipment	9,375	11,393	11,242	12,172	13,431
Metalworking Machinery	3,475	3,927	4,324	4,324	4,497
Lathes	628	783	940	945	762
Textile Machinery	1,852	2,161	2,552	2,951	3,381
Sewing Machines	861	980	1,084	1,095	1,159
Pulp and Paper Machinery	280	281	329	417	544
Printing and Bookbinding Machinery	636	837	1,033	1,123	1,292
Construction and Mining Machinery	2,179	2,400	2,523	2,671	2,387
Excavators	1,191	1,776	1,890	1,970	1,581
Heating and Cooling Machinery	2,032	2,530	2,716	2,805	3,470
Pumps and Centrifuges	2,159	3,876	4,146	4,224	4,589
Air and Gas Compressors	855	1,520	1,620	1,505	1,532
Mechanical Handling Equipment	1,991	2,583	2,949	3,046	3,291
Bearings	919	1,217	1,382	1,458	1,466
Electric Machinery	40,883	61,975	64,454	65,925	73,724
Electric Power Machinery	2,724	3,405	3,528	3,652	4,254
Generators	469	488	539	568	613
Motors	808	1,155	1,172	1,248	1,427
Switchboards and Control Panels	877	1,066	1,163	1,080	1,420
Insulated Wire and Cable	693	827	902	947	1,057
Telecommunications Equipment	15,071	*	*	*	*
Televisions	1,422	*	*	*	*
Radios	2,464	*	*	*	*
Microphones, Loudspeakers and Amplifiers	1,169	*	*	*	*
Household Electric Appliances	1,713	1,485	1,198	1,136	1,244
Batteries	729	930	960	1,036	1,277
Electronic Tubes and Semiconductors	8,312	12,327	14,123	13,348	14,860
Tubes	1,795	2,242	2,239	2,169	2,491
Discrete Devices	4,212	1,709	1,798	1,868	2,229
Integrated Circuits	n.a.	6,603	8,354	7,586	8,249
Automotive Electrical Equipment	1,146	1,269	1,482	1,547	1,580
Electronic Measuring and Controlling Instruments	1,681	2,322	2,753	2,747	3,030
Condensers	826	1,131	1,118	1,161	1,336
Transport Equipment	63,925	65,741	66,596	71,814	77,916
Railway Equipment	624	573	385	352	190
Road Motor Vehicles	44,942	48,787	48,469	50,959	54,765
Cars	35,693	38,671	38,804	41,348	44,713
Assembled Trucks and Buses	7,324	9,628	9,124	9,061	9,545
Truck and Bus Chassis with Engines	1,815	350	398	438	337
Road Motor Vehicle Parts	10,714	9,131	9,902	10,850	11,316

(continued)

Table 34: Japan's Exports by Commodity, 1987-1991 (continued)

(in millions of dollars, f.o.b. value basis)

	1987	1988	1989	1990	1991
Motorcycles and Parts	$2,628	$2,368	$2,458	$2,758	$3,418
Bicycles and Parts	402	594	532	852	921
Aircraft and Parts	220	300	383	436	538
Ships and Boats	4,360	3,947	4,428	5,566	6,722
Tankers	718	769	1,108	1,735	3,016
Cargo Ships	1,805	1,338	1,827	2,461	2,402
Miscellaneous Manufactured Goods	31,599	24,174	24,183	25,893	28,508
Clothing	665	588	563	564	576
Scientific, Medical and Optical Instruments	9,448	10,835	11,181	11,554	12,935
Copying Machines	n.a.	2,324	2,397	2,434	2,627
Cameras Lenses	548	508	446	488	517
Still Cameras	1,617	1,673	1,721	1,706	1,746
Measuring Instruments	945	1,195	1,228	1,323	1,449
Watches and Clocks	1,981	2,365	2,156	2,292	2,558
Stereo Equipment and Audio and Videocassette Recorders and Players	10,085	*	*	*	*
Videocassette Recorders	5,900	*	*	*	*
Photographic Supplies	n.a.	2,577	2,617	2,788	3,011
Film in Rolls	n.a.	783	763	823	888
Phonograph Records and Tapes	1,969	2,041	1,960	2,254	2,319
Musical Instruments	1,31	1,341	1,145	1,153	1,177
Plastic Products	486	556	609	638	708
Office and Stationery Supplies	582	697	706	791	849
Unclassified Commodities	2,369	3,591	3,943	4,582	5,007
*Addendum:					
Visual Equipment		12,117	11,645	13,058	14,026
Televisions		1,779	1,666	2,071	2,188
Videocassette Recorders and Players		6,203	6,091	6,395	5,749
Television Cameras		4,136	3,888	4,592	6,089
Audio Equipment		6,373	6,222	6,472	7,412
Radios		2,212	2,181	2,474	3,118
Tape Recorders		1,599	1,619	1,451	1,439
Compact Disk Players		1,328	1,261	1,294	1,499
Microphones, Loudspeakers and Amplifiers		1,235	1,162	1,253	1,356
Parts of Audio-Visual Equipment		3,127	3,169	3,282	3,744
Telephone and Telegraph Equipment		6,629	6,425	6,035	6,628
Facsimile Machines		2,811	2,553	2,002	2,063

Source: Ministry of Finance

Table 35: Japan's Imports by Commodity, 1987-1991

(in millions of dollars, c.i.f. value basis)

	1987	1988	1989	1990	1991
Total Imports	$149,515	$187,354	$210,847	$234,799	$236,737
Food and Live Animals	20,752	26,960	28,130	28,249	30,740
Meat and Meat Products	3,338	4,313	4,899	5,011	5,480
Fresh and Frozen Beef	800	1,190	1,645	1,885	1,805
Fresh and Frozen Pork	1,417	1,653	1,634	1,671	1,988
Fresh and Frozen Poultry	322	437	501	553	717
Dairy Products and Eggs	292	499	539	502	618
Fish and Fish Products	7,992	10,461	10,033	10,508	11,820
Fresh and Frozen Shrimp and Lobster	2,510	2,848	2,590	2,833	3,070
Fresh and Frozen Salmon	643	1,070	932	961	751
Grains and Cereal Products	3,160	4,241	4,796	4,584	4,383
Wheat	785	1,034	1,188	1,006	918
Corn for Mixed Feed	1,101	1,490	1,603	1,652	1,596
Sorghum for Mixed Feed	326	422	507	485	420
Fruits and Vegetables	2,832	3,706	3,939	3,896	4,397
Fruits	1,757	2,128	2,267	2,225	2,495
Vegetables	1,075	1,578	1,672	1,671	1,903
Sugar	290	456	517	519	456
Coffee	838	888	891	642	693
Animal Feeds	776	1,225	1,259	1,304	1,545
Beverages and Tobacco	1,643	2,160	2,882	3,323	3,733
Alcoholic Beverages	574	855	1,313	1,715	1,851
Cigarettes	512	751	944	1,036	1,222
Crude Materials (excl. fuels)	21,751	27,633	30,248	28,055	26,690
Hides and Skins	585	761	696	771	520
Oilseeds and Oil Nuts	1,617	2,153	2,124	2,087	1,929
Soybeans	1,087	1,426	1,352	1,259	1,146
Rapeseed	329	497	514	557	520
Rubber	661	965	833	736	781
Logs and Lumber	6,227	7,122	8,201	7,472	7,150
Logs	4,348	4,546	5,055	4,501	4,135
Lumber	1,879	2,576	3,146	2,970	3,016
Wood Pulp	1,441	1,980	2,479	1,922	1,619
Textile Fibers and Waste	2,702	3,309	3,337	2,643	2,456
Wool	1,017	1,447	1,382	1,019	828
Cotton	1,137	1,318	1,382	1,205	1,250
Crude Minerals	1,069	1,348	1,615	1,681	1,727
Metal Ores, Concentrates and Scrap	6,120	8,488	9,333	9,119	8,777
Iron Ore and Concentrates	2,618	2,853	3,147	3,374	3,641
Nonferrous Ores	2,404	4,104	4,683	4,342	3,940
Copper	1,476	2,472	2,583	2,441	2,249
Zinc	197	293	446	517	325
Nonferrous Scrap	773	1,090	1,099	1,068	899
Aluminum Scrap	531	695	686	485	347

(continued)

Table 35: Japan's Imports by Commodity, 1987-1991 (continued)

(in millions of dollars, c.i.f. value basis)

	1987	1988	1989	1990	1991
Mineral Fuels	$39,137	$38,356	$43,053	$56,732	$54,756
Coal	4,634	5,375	5,859	6,187	6,395
Coking Coal	3,582	4,127	4,312	4,498	4,570
Petroleum and Products	27,445	25,807	29,823	41,254	37,814
Crude Petroleum	20,663	18,852	21,544	31,584	30,181
Petroleum Products	6,782	6,955	8,279	9,670	7,633
Residual Fuel Oil	1,477	1,165	1,308	1,656	1,062
Natural and Manufactured Gas	7,022	7,128	7,304	9,227	10,479
Liquefied Petroleum Gas	1,970	1,953	1,842	2,540	2,755
Liquefied Methane Gas	5,052	5,170	5,457	6,685	7,723
Animal and Vegetable Oils and Fats	271	407	423	412	477
Chemicals	11,845	14,830	15,949	16,045	17,412
Chemical Elements and Compounds	5,470	6,889	7,180	6,935	7,641
Organic Chemicals	3,494	4,555	4,659	4,457	4,935
Inorganic Chemicals	869	1,130	1,297	1,194	1,324
Dyeing, Tanning and Coloring Materials	542	652	680	700	710
Pharmaceuticals	2,110	2,658	2,731	2,834	3,111
Bulk Antibiotics	451	534	524	479	526
Plastic Materials	1,163	1,474	1,641	1,660	1,847
Manufactured Goods Classified Mainly by Material	18,055	27,340	30,767	30,934	31,950
Tires and Other Rubber Manufactures	437	602	709	745	818
Wood Manufactures	1,678	2,071	2,901	2,980	3,285
Plywood	n.a.	610	1,068	1,031	1,001
Wood Chips	819	1,069	1,357	1,433	1,699
Paper and Paper Products	873	1,144	1,258	1,121	1,182
Textiles (excl. fibers and apparel)	2,975	3,929	4,341	4,100	4,319
Nonmetallic Mineral Manufactures	2,847	4,150	4,768	5,375	4,886
Glass and Glassware	350	496	612	699	693
Diamonds	1,429	2,078	2,232	2,547	2,065
Steel	2,484	4,625	5,069	4,584	5,503
Ferroalloys	581	1,103	1,256	911	1,013
Plates, Sheets, Coils and Strip	607	2,201	2,463	2,073	2,690
Nonferrous Metals	5,644	9,312	9,915	9,875	9,576
Precious Metals	1,414	1,712	1,506	1,736	1,666
Copper and Alloys	691	1,274	1,698	1,929	1,802
Aluminum and Alloys	2,669	5,030	5,080	4,771	4,598
Metal Manufactures	882	1,245	1,497	1,762	2,021
Machinery and Transport Equipment	17,264	24,727	29,894	37,867	39,458
Nonelectric Machinery	6,746	9,322	11,467	13,983	14,365
Power Generating Machinery	1,136	1,292	1,421	1,597	1,510
Aircraft Engines	813	924	937	1,000	860
Office Machinery	2,218	3,279	4,366	5,226	5,584
Computers, Peripheral Equipment and Parts	2,169	3,210	4,286	5,132	5,492
Metalworking Machinery	277	436	525	670	673
Heating and Cooling Machinery	270	427	513	549	755

(continued)

Table 35: Japan's Imports by Commodity, 1987-1991 (continued)

(in millions of dollars, c.i.f. value basis)

	1987	1988	1989	1990	1991
Pumps and Centrifuges	$408	$521	$609	$791	$862
Electric Machinery	5,894	9,289	11,488	12,813	14,650
Electric Power Machinery	470	731	917	1,083	1,280
Electronic Tubes and Semiconductors	1,531	2,284	2,860	3,310	3,911
Integrated Circuits	n.a.	1,758	2,254	2,596	3,017
Telecommunications Equipment	975	*	*	*	*
Electronic Measuring and Controlling Instruments	918	1,530	1,808	1,849	1,938
Transport Equipment	4,624	6,117	6,939	11,072	10,444
Cars	2,031	3,038	4,009	6,189	5,180
Automotive Parts	340	430	559	775	932
Aircraft	1,742	2,024	1,656	3,165	3,234
Miscellaneous Manufactured Goods	13,396	18,702	23,722	27,012	25,880
Furniture	665	1,033	1,241	1,425	1,625
Travel Goods and Handbags	514	778	1,035	1,313	1,488
Clothing	4,649	6,702	8,942	8,704	9,341
Footwear	784	1,108	1,117	1,283	1,532
Scientific, Medical and Optical Instruments	1,208	1,310	1,593	1,878	2,213
Watches and Clocks	427	624	889	1,118	1,180
Photographic Supplies	489	584	521	511	539
Phonograph Records and Tapes	304	471	549	531	565
Plastic Products	341	473	561	651	759
Toys and Games	391	444	472	530	655
Sporting Goods	558	810	1,034	1,201	1,180
Art Works and Antiques	989	1,712	2,565	4,223	1,049
Unclassified Commodities	5,402	6,240	5,780	6,169	5,641
Nonmonetary Gold	3,467	4,102	3,491	3,575	2,634
*Addendum:					
Audio-Visual Equipment and Parts		1,421	1,922	1,759	2,216
Telephone and Telegraph Equipment		513	687	857	971

Source: Ministry of Finance

Table 36: Japan's Dollar-Based Trade with the United States, 1987-1991

(in millions of dollars, customs clearance basis, seasonally unadjusted)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1987		$83,580	3.9%	$31,491	8.4%	$52,090
1988		89,634	7.2	42,037	33.5	47,597
1989		93,189	4.0	48,246	14.8	44,943
1990		90,322	-3.1	52,369	8.5	37,954
1991		91,538	1.3	53,317	1.8	38,220
1990	January	6,206	-4.6	4,016	13.7	2,189
	February	7,131	-5.8	4,174	21.9	2,957
	March	8,325	-3.8	4,563	-1.7	3,761
	April	6,731	-15.0	4,294	27.5	2,438
	May	6,816	-4.5	4,394	0.2	2,422
	June	7,391	-6.9	4,173	-3.2	3,218
	July	7,528	-7.0	4,463	5.4	3,065
	August	7,118	-3.0	4,294	-0.7	2,824
	September	8,286	-4.5	3,972	1.8	4,314
	October	8,466	6.9	4,750	16.1	3,717
	November	8,082	5.5	4,523	10.4	3,559
	December	8,242	6.0	4,753	20.8	3,489
1991	January	6,667	7.4	4,275	6.4	2,391
	February	7,415	4.0	4,565	9.4	2,850
	March	8,230	-1.1	4,428	-3.0	3,801
	April	6,498	-3.5	4,235	-1.4	2,263
	May	6,757	-0.9	4,826	9.8	1,932
	June	7,048	-4.6	4,403	5.5	2,645
	July	7,668	1.9	4,663	4.5	3,005
	August	7,516	5.6	4,562	6.2	2,954
	September	8,535	3.0	3,960	-0.3	4,575
	October	8,606	1.7	4,761	0.2	3,845
	November	8,203	1.5	4,709	4.1	3,494
	December	8,396	1.9	3,931	-17.3	4,465

Source: Ministry of Finance

Table 37: Japan's Yen-Based Trade with the United States, 1987-1991

(in billions of yen, customs clearance basis, seasonally unadjusted)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1987		Y12,148	-10.4%	Y4,582	-6.8%	Y7,566
1988		11,487	-5.4	5,388	17.6	6,099
1989		12,816	11.6	6,632	23.1	6,184
1990		13,057	1.9	7,586	14.4	5,471
1991		12,324	-5.6	7,191	-5.2	5,133
1990	January	897	9.6	580	30.6	317
	February	1,034	6.3	605	37.5	429
	March	1,240	11.9	678	14.1	561
	April	1,058	1.1	674	51.5	384
	May	1,069	11.8	690	17.7	379
	June	1,127	-0.8	636	3.0	491
	July	1,142	-0.4	678	13.1	463
	August	1,060	2.9	639	5.4	420
	September	1,182	-6.2	568	0.3	614
	October	1,132	0.2	636	9.0	497
	November	1,037	-5.1	580	-0.7	457
	December	1,080	-3.4	622	9.9	458
1991	January	902	0.5	578	-0.3	324
	February	971	-6.1	598	-1.2	373
	March	1,103	-11.0	594	-12.5	510
	April	894	-15.5	583	-13.5	311
	May	931	-12.9	665	-3.7	267
	June	981	-12.9	612	-3.7	369
	July	1,064	-6.8	647	-4.5	417
	August	1,030	-2.9	625	-2.3	405
	September	1,161	-1.7	540	-5.0	622
	October	1,134	0.1	627	-1.3	507
	November	1,070	3.2	614	5.9	455
	December	1,083	0.3	508	-18.4	576

Source: Ministry of Finance

Table 38: Japan's Foreign Direct Investment by Country, FY 1987-FY 1991

(in millions of dollars)

	FY 1987	FY 1988	FY 1989	FY 1990	FY 1991	Total March 31, 1992
United States	$14,704	$21,701	$32,540	$26,128	$18,026	$148,554
Canada	653	626	1,362	1,064	797	6,454
North America	15,357	22,328	33,902	27,192	18,823	155,008
United Kingdom	2,473	3,956	5,239	6,806	3,588	26,186
Netherlands	829	2,359	4,547	2,744	1,960	14,776
Luxembourg	1,764	657	654	224	266	5,873
West Germany	403	409	1,083	1,242	1,115	5,805
France	330	463	1,135	1,257	817	4,973
Switzerland	224	454	397	666	62	2,558
Spain	283	161	501	320	378	2,245
Belgium	70	164	326	367	222	1,941
Italy	59	108	314	217	322	1,222
Europe	6,576	9,116	14,808	14,294	9,371	68,636
Indonesia	545	586	631	1,105	1,193	12,733
Hong Kong	1,072	1,662	1,898	1,785	925	10,775
Singapore	494	747	1,902	840	613	7,168
Thailand	250	859	1,276	1,154	807	5,229
South Korea	647	483	606	284	260	4,398
Malaysia	163	387	673	725	880	4,111
China	1,226	296	438	349	579	3,402
Taiwan	367	372	494	446	405	3,135
Philippines	72	134	202	258	203	1,783
Asia	4,868	5,569	8,238	7,054	5,936	53,455
Panama	2,305	1,712	2,044	1,342	1,557	17,801
Caymans	1,197	2,609	1,658	588	158	7,489
Brazil	229	510	349	615	171	6,731
Bahamas	734	737	620	121	103	3,562
Mexico	28	87	36	168	193	2,067
Bermuda	36	337	228	360	232	1,810
Latin America	4,816	6,428	5,238	3,628	3,337	43,821
Australia	1,222	2,413	4,256	3,669	2,550	18,613
New Zealand	121	117	101	231	236	1,161
Oceania	1,413	2,669	4,618	4,166	3,278	21,376
Liberia	267	648	643	531	707	5,539
Africa	272	653	671	551	748	6,574
Neutral Zone	54	20	32	26	26	1,467
Iran	---	1	1	---	1	1,007
Middle East	62	259	66	27	90	3,522
Total	33,364	47,022	67,540	56,911	41,584	352,392

Source: Ministry of Finance

Table 39: Japan's Foreign Direct Investment by Industry, FY 1987-FY 1991

(in millions of dollars)

	FY 1987	FY 1988	FY 1989	FY 1990	FY 1991	Total March 31, 1992
Manufacturing Sector	$7,832	$13,805	$16,284	$15,486	$12,311	$93,924
Food Products	328	419	1,300	821	632	4,717
Textiles	206	317	533	796	616	4,615
Wood and Paper Products	317	604	555	314	312	3,280
Chemicals	910	1,292	2,109	2,292	1,602	12,542
Metals	786	1,367	1,591	1,047	907	11,215
Nonelectric Machinery	687	1,432	1,762	1,454	1,284	9,216
Electric Machinery	2,421	3,041	4,480	5,684	2,296	22,656
Transport Equipment	1,473	1,281	2,053	1,872	1,996	12,877
Other	703	4,051	1,901	1,207	2,666	12,804
Nonmanufacturing Sector	25,080	32,634	50,517	40,620	28,809	251,946
Agriculture and Forestry	97	162	151	153	276	1,635
Fisheries	44	94	47	59	72	810
Mining	511	1,013	1,262	1,328	1,003	17,542
Construction	87	309	646	300	429	2,818
Trade and Sales	2,269	3,204	5,148	6,158	5,247	36,564
Banking, Finance and Insurance	10,673	13,104	15,395	8,047	4,972	70,290
Services	2,780	3,732	10,616	11,292	5,413	40,079
Transportation	2,145	2,372	2,927	2,169	2,489	19,927
Real Estate	5,428	8,641	14,143	11,107	8,899	54,748
Other	1,047	3	180	8	10	7,533
Branch Offices	452	584	739	806	464	5,928
Other Transactions*	---	---	---	---	---	595
Total	33,364	47,022	67,540	56,911	41,584	352,392

*Certain overseas real estate transactions have been excluded from Japan's foreign direct investment data since December 1, 1980 because of changes in the Foreign Exchange and Foreign Trade Control Law.

Source: Ministry of Finance

Table 40: U.S. International Transactions, 1987-1991

(in millions of dollars, IMF value basis)

	1987	1988	1989	1990	1991
Merchandise Trade Balance	$-159,557	$-126,959	$-115,668	$-108,853	$-73,436
Exports	250,208	320,230	361,697	388,705	415,962
Imports	409,765	447,189	477,365	497,558	489,398
Services Balance	19,136	25,173	40,132	51,342	61,725
Military	-3,812	-6,354	-6,838	-7,818	-5,524
Travel	-5,592	-2,449	3,153	6,069	11,799
Other Transportation	-806	1,079	2,698	4,073	5,319
Investment Income	10,945	12,466	14,366	19,287	16,429
Direct Investments	30,655	38,743	47,847	54,345	52,896
Portfolio Investments	-19,710	-26,276	-33,481	-35,058	-36,467
Fees and Royalties	8,070	9,217	10,462	13,337	13,815
Other Services	10,330	11,213	16,290	16,393	19,886
Unilateral Transfers Balance	-23,052	-24,869	-25,606	-32,916	8,028
Current Account Balance	-163,473	-126,656	-101,142	-90,428	-3,682
Private Capital Flows (net)	112,029	87,969	114,282	9,004	-22,806
Direct Investments (net)	31,038	41,830	38,877	12,443	-15,638
Securities (net)	29,226	38,746	46,315	-29,707	6,142
Banking Flows (net)	46,907	13,913	12,127	23,839	-18,431
Other Flows (net)	4,858	-6,520	16,963	2,429	5,121
U.S. Government Assets (other than official reserves) (net)	1,006	2,967	1,271	2,304	3,397
U.S. Official Reserve Assets (net)	9,149	-3,912	-25,293	-2,158	5,763
Foreign Official Assets (net)	45,387	39,758	8,489	33,908	18,407
Statistical Discrepancy	-4,096	-126	2,394	47,370	-1,078

Note: For capital transactions, credits (+) indicate net inflows and debits (-) indicate net outflows.

Source: Department of Commerce

Table 41: U.S. Transactions with Japan, 1987-1991

(in millions of dollars, IMF value basis)

	1987	1988	1989	1990	1991
Merchandise Trade Balance	$-56,959	$-52,618	$-49,667	$-41,787	$-44,289
Exports	27,619	37,183	43,864	47,807	47,213
Imports	84,578	89,801	93,531	89,594	91,502
Services Balance	-171	2,030	4,456	9,535	12,392
Military	-1,705	-1,730	-1,388	-1,347	-1,010
Travel	2,369	3,054	5,181	5,634	6,257
Other Transportation	256	437	1,322	1,946	1,882
Investment Income	-3,718	-3,168	-4,401	-402	410
Direct Investments	1,475	1,420	1,413	2,873	3,847
Portfolio Investments	-5,193	-4,588	-5,814	-3,274	-3,437
Fees and Royalties	1,591	2,058	2,108	2,381	2,602
Other Services	1,036	1,379	1,636	1,324	2,250
Unilateral Transfers Balance	-93	-110	-176	231	8,800
Current Account Balance	-57,223	-50,698	-45,387	-32,020	-23,097
U.S. Government and Private Assets in Japan (net)	-17,360	-42,049	-24,911	22,166	-10,403
Japanese Government and Private Assets in United States (net)	42,716	86,501	23,623	-26,551	-3,201
Statistical Discrepancy	31,867	6,246	46,675	36,406	36,701

Note: For capital transactions, credits (+) indicate net inflows and debits (-) indicate net outflows.

Source: Department of Commerce

Table 42: U.S. Exports and Imports, 1987-1991*

(in millions of dollars, seasonally unadjusted)

		Exports (f.a.s.)	Change Over Year-Earlier Period	Imports (Customs)	Change Over Year-Earlier Period	Trade Balance
1987		$254,122	11.9%	$406,241	11.2%	$-152,119
1988		322,426	26.9	440,952	8.5	-118,526
1989		363,812	12.8	473,211	7.3	-109,399
1990		393,592	8.2	495,311	4.7	-101,718
1991		421,730	7.1	487,129	-1.7	-65,399
1990	January	30,664	11.3	40,304	11.4	-9,640
	February	30,962	10.9	37,112	1.5	-6,150
	March	35,971	8.2	42,339	5.3	-6,369
	April	32,617	5.0	39,144	2.4	-6,527
	May	33,539	6.5	40,846	-0.3	-7,308
	June	34,470	8.3	40,946	1.0	-6,476
	July	30,736	7.1	41,495	5.6	-10,759
	August	31,723	7.9	42,232	4.4	-10,509
	September	31,444	5.8	40,602	5.0	-9,157
	October	35,310	11.2	47,395	8.9	-12,085
	November	33,267	9.9	43,796	6.7	-10,529
	December	32,889	6.5	39,100	4.1	-6,211
1991	January	33,165	8.2	40,095	-0.5	-6,930
	February	32,775	5.9	36,830	-0.8	-4,056
	March	36,820	2.4	38,573	-8.9	-1,753
	April	36,137	10.8	39,424	0.7	-3,287
	May	36,024	7.4	40,056	-1.9	-4,033
	June	35,480	2.9	39,344	-3.9	-3,864
	July	33,444	8.8	41,297	-0.5	-7,853
	August	33,633	6.0	41,030	-2.8	-7,397
	September	34,391	9.4	41,478	2.2	-7,087
	October	37,897	7.3	46,466	-2.0	-8,570
	November	36,970	11.1	41,778	-4.6	-4,808
	December	34,996	6.4	40,758	4.2	-5,762

*The export and import data reflect revisions not necessarily incorporated in other tables. The export statistics cover domestic and foreign merchandise, including Department of Defense shipments.

Source: Department of Commerce

Table 43: U.S. Exports by Major Market, 1987-1991

(in millions of dollars, f.a.s. value basis)

	1987	1988	1989	1990	1991
Total Exports	$254,122	$322,426	$363,812	$393,592	$421,730
Developed Countries	165,375	206,805	234,575	256,725	263,480
Japan	28,249	37,725	44,494	48,580	48,125
Canada	59,814	71,622	78,809	83,674	85,150
Western Europe	69,718	87,858	100,165	113,067	118,682
United Kingdom	14,114	18,364	20,837	23,490	22,046
West Germany	11,748	14,348	16,862	18,760	21,302
France	7,943	9,970	11,579	13,665	15,346
Netherlands	8,217	10,117	11,364	13,022	13,511
Belgium-Luxembourg	6,189	7,411	8,522	10,451	10,789
Italy	5,530	6,775	7,215	7,992	8,570
Spain	3,148	4,215	4,796	5,213	5,474
Ireland	1,810	2,183	2,483	2,540	2,681
Denmark	893	969	1,051	1,311	1,574
European Community	60,575	75,755	86,331	98,129	103,122
Switzerland	3,151	4,196	4,911	4,943	5,557
Sweden	1,894	2,700	3,139	3,405	3,287
Turkey	1,483	1,850	2,003	2,243	2,468
Norway	842	929	1,037	1,281	1,489
Australia	5,495	6,973	8,331	8,538	8,404
South Africa	1,281	1,688	1,659	1,732	2,113
Developing Countries	81,691	106,727	117,769	127,328	146,745
Latin America	31,574	40,024	44,396	49,284	58,891
Mexico	14,582	20,628	24,982	28,279	33,277
Brazil	4,040	4,267	4,804	5,048	6,148
Venezuela	3,586	4,612	3,025	3,108	4,656
Colombia	1,412	1,754	1,924	2,029	1,952
Chile	796	1,066	1,414	1,664	1,839
Dominican Republic	1,142	1,359	1,645	1,656	1,743
East Asian Newly Industrialized Countries	23,547	34,816	38,429	40,734	45,628
South Korea	8,099	11,232	13,459	14,404	15,505
Taiwan	7,413	12,129	11,335	11,491	13,182
Singapore	4,053	5,768	7,345	8,023	8,804
Hong Kong	3,983	5,687	6,291	6,817	8,137
Other Developing Countries	26,570	31,887	34,944	37,310	42,225
Malaysia	1,897	2,142	2,871	3,425	3,900
Thailand	1,544	1,962	2,288	2,995	3,753
India	1,463	2,500	2,458	2,486	1,999
Philippines	1,599	1,878	2,202	2,471	2,265
Indonesia	767	1,059	1,247	1,897	1,892
Saudi Arabia	3,373	3,776	3,574	4,049	6,557
Israel	3,130	3,244	2,827	3,203	3,911
Nigeria	295	357	490	553	831
Eastern Europe and Communist Asia	5,723	8,686	11,073	9,018	11,082
China	3,497	5,021	5,755	4,806	6,278
Soviet Union	1,480	2,769	4,285	3,087	3,579

Source: Department of Commerce

Table 44: U.S. Imports by Major Supplier, 1987-1991

(in millions of dollars, Customs value basis)

	1987	1988	1989	1990	1991
Total Imports	$406,241	$440,952	$473,211	$495,311	$487,129
Developed Countries	256,553	277,575	289,882	297,444	291,762
Japan	84,575	89,519	93,553	89,684	91,511
Canada	71,085	81,398	87,953	91,380	91,064
Western Europe	95,496	100,443	101,764	109,039	102,262
United Kingdom	17,341	17,976	18,319	20,188	18,413
West Germany	27,069	26,362	24,833	28,162	26,137
France	10,730	12,509	13,014	13,153	13,333
Netherlands	3,964	4,559	4,810	4,952	4,811
Belgium-Luxembourg	4,171	4,493	4,555	4,585	4,117
Italy	11,040	11,576	11,933	12,751	11,764
Spain	2,839	3,204	3,317	3,311	2,848
Ireland	1,112	1,375	1,566	1,755	1,948
Denmark	1,779	1,664	1,535	1,678	1,661
European Community	81,188	84,939	85,153	91,877	86,157
Switzerland	4,249	4,611	4,714	5,587	5,576
Sweden	4,758	4,985	4,892	4,937	4,525
Turkey	821	979	1,372	1,183	1,006
Norway	1,404	1,446	1,991	1,630	1,624
Australia	3,007	3,541	3,873	4,447	3,988
South Africa	1,346	1,513	1,531	1,698	1,728
Developing Countries	141,129	152,702	169,273	180,445	174,597
Latin America	44,371	48,789	54,816	61,035	59,475
Mexico	20,271	23,260	27,162	30,157	31,130
Brazil	7,865	9,294	8,410	7,898	6,717
Venezuela	5,579	5,157	6,771	9,480	8,179
Colombia	2,232	2,161	2,555	3,168	2,736
Chile	981	1,182	1,292	1,313	1,302
Dominican Republic	1,163	1,410	1,646	1,752	2,008
East Asian Newly Industrialized Countries	57,664	63,060	62,774	60,573	59,277
South Korea	16,987	20,105	19,737	18,485	17,019
Taiwan	24,622	24,714	24,313	22,666	23,023
Singapore	6,201	7,973	9,003	9,800	9,957
Hong Kong	9,854	10,238	9,722	9,622	9,279
Other Developing Countries	39,094	40,853	51,683	58,837	55,846
Malaysia	2,921	3,692	4,744	5,272	6,102
Thailand	2,220	3,210	4,380	5,289	6,122
India	2,529	2,940	3,315	3,197	3,193
Philippines	2,264	2,666	3,068	3,384	3,471
Indonesia	3,394	3,150	3,529	3,341	3,241
Saudi Arabia	4,433	5,620	7,157	10,021	10,900
Israel	2,639	2,972	3,239	3,313	3,484
Nigeria	3,573	3,279	5,284	5,982	5,168
Eastern Europe and Communist Asia	8,219	10,675	14,056	17,422	20,770
China	6,293	8,511	11,990	15,237	18,969
Soviet Union	425	586	709	1,059	802

Source: Department of Commerce

Table 45: U.S. Trade Balance with Major Trading Partners, 1987-1991

(in millions of dollars; exports f.a.s., imports Customs)

	1987	1988	1989	1990	1991
Overall Trade Balance	$-152,119	$-118,526	$-109,399	$-101,718	$-65,399
Developed Countries	-91,178	-70,770	-55,306	-40,719	-28,281
Japan	-56,326	-51,794	-49,059	-41,105	-43,385
Canada	-11,271	-9,776	-9,144	-7,707	-5,914
Western Europe	-25,778	-12,585	-1,599	4,029	16,420
United Kingdom	-3,227	388	2,518	3,302	3,633
West Germany	-15,322	-12,014	-7,970	-9,402	-4,834
France	-2,787	-2,539	-1,435	511	2,013
Netherlands	4,253	5,558	6,554	8,070	8,700
Belgium-Luxembourg	2,019	2,917	3,967	5,866	6,671
Italy	-5,510	-4,801	-4,718	-4,760	-3,194
Spain	310	1,012	1,479	1,901	2,626
Ireland	699	809	917	784	733
Denmark	-886	-695	-484	-367	-87
European Community	-20,613	-9,183	1,178	6,252	16,965
Switzerland	-1,098	-415	197	-645	-19
Sweden	-2,865	-2,285	-1,753	-1,533	-1,238
Turkey	661	871	632	1,061	1,462
Norway	-562	-517	-955	-549	-135
Australia	2,488	3,432	4,458	4,091	4,416
South Africa	-64	175	128	34	385
Developing Countries	-59,438	-45,976	-51,505	-53,117	-27,853
Latin America	-12,797	-8,764	-10,420	-11,751	-584
Mexico	-5,689	-2,631	-2,180	-1,878	2,148
Brazil	-3,825	-5,028	-3,606	-2,850	-569
Venezuela	-1,993	-546	-3,745	-6,371	-3,522
Colombia	-821	-406	-631	-1,139	-784
Chile	-185	-116	122	351	537
Dominican Republic	-21	-50	-1	-96	-265
East Asian Newly Industrialized Countries	-34,117	-28,214	-24,345	-19,839	-13,648
South Korea	-8,888	-8,873	-6,278	-4,081	-1,514
Taiwan	-17,209	-12,585	-12,978	-11,175	-9,841
Singapore	-2,148	-2,206	-1,659	-1,778	-1,153
Hong Kong	-5,871	-4,550	-3,431	-2,805	-1,141
Other Developing Countries	-12,524	-8,966	-16,739	-21,527	-13,620
Malaysia	-1,025	-1,550	-1,874	-1,847	-2,202
Thailand	-676	-1,248	-2,091	-2,293	-2,369
India	-1,065	-439	-857	-711	-1,193
Philippines	-665	-788	-866	-913	-1,206
Indonesia	-2,627	-2,092	-2,282	-1,444	-1,349
Saudi Arabia	-1,060	-1,844	-3,583	-5,971	-4,343
Israel	491	273	-412	-110	428
Nigeria	-3,278	-2,922	-4,794	-5,429	-4,337
Eastern Europe and Communist Asia	-2,496	-1,989	-2,938	-8,404	-9,689
China	-2,796	-3,490	-6,235	-10,431	-12,691
Soviet Union	1,055	2,183	3,574	2,028	2,777

Source: Department of Commerce

Table 46: U.S. Exports by End-Use Category, 1987-1991

(in millions of dollars, f.a.s. value)

	1987	1988	1989	1990	1991
Total Exports	$253,906	$322,498	$363,759	$392,922	$421,597
Food, Feed and Beverages	24,737	32,856	37,058	34,948	35,650
Wheat	3,272	5,104	6,120	4,016	3,482
Corn	3,255	5,101	6,852	6,274	5,228
Sorghum, Barley and Oats	640	845	1,167	1,024	835
Other Animal Feeds	2,698	3,428	2,901	2,661	2,929
Soybeans	4,305	4,884	3,973	3,570	4,000
Meat and Meat Products	1,861	2,635	3,141	3,335	3,869
Fish and Fish Products	1,637	2,211	2,515	2,932	3,220
Fruits and Fruit Products	1,634	1,922	2,529	2,808	3,020
Vegetables and Vegetable Products	609	1,028	1,565	1,800	1,868
Industrial Supplies and Materials	67,842	86,732	99,325	104,916	109,449
Raw Cotton	1,655	1,979	2,266	2,800	2,487
Unmanufactured Tobacco	1,107	1,262	1,300	1,461	1,422
Hides and Skins (incl. furskins)	1,752	1,850	1,776	1,761	1,383
Metallurgical-Grade Coal	2,264	2,735	2,939	3,048	3,063
Other Coal	1,171	1,363	1,731	1,993	2,168
Fuel Oil	1,961	1,684	1,760	2,469	2,913
Other Petroleum Products	2,316	2,396	3,409	4,504	4,032
Nuclear Fuel Materials and Fuels	907	747	1,329	1,116	1,150
Logs, Lumber, Plywood and Veneers	3,342	4,510	5,187	5,225	4,924
Paper Base Stocks	3,109	4,017	4,421	4,108	3,699
Newsprint and Other Paper Products	2,905	3,490	4,025	4,355	5,055
Synthetic Fibers, Yarn and Fabric	1,823	2,288	2,493	2,723	2,852
Plastic Materials	4,993	6,617	6,155	6,504	7,607
Fertilizers, Pesticides and Insecticides	3,883	4,345	4,090	3,948	4,285
Industrial Inorganic Chemicals	1,585	2,026	3,006	2,819	2,946
Industrial Organic Chemicals	5,921	7,610	9,010	8,801	9,298
Iron Ore, Steel Scrap and Ferroalloys	1,244	1,685	2,457	2,104	1,677
Steel Slabs, Bars, Wire Rods, Plates and Sheets	640	1,200	2,504	2,135	2,769
Steel Strip, Wire, Shapes, Pipes, Tubes and Fasteners	779	1,019	1,582	1,575	1,709
Aluminum	1,695	2,925	3,547	3,206	3,249
Copper	655	1,353	1,708	1,828	1,745
Nonmonetary Gold	1,881	5,170	2,417	2,990	3,354
Other Nonferrous Metals	1,159	1,522	1,805	1,949	1,771
Fabricated Metal Products	2,183	2,754	3,047	3,212	3,679
Manufactured Mineral Supplies	846	980	1,478	1,645	1,743
Blank Audio and Video Tapes and Other Media	838	1,245	1,412	1,799	1,890
Capital Goods	90,657	115,417	138,708	152,120	166,336
Electric Machinery	8,382	10,827	11,313	12,661	13,492
Generators, Transformers and Accessories	1,621	2,105	1,866	2,108	2,287
Other Electric Apparatus and Parts	6,760	8,721	9,447	10,553	11,205
Nonelectric Machinery	64,447	81,899	99,161	105,692	114,757
Drilling and Oilfield Equipment	1,845	2,408	2,846	3,157	4,596
Excavating, Paving and Construction Machinery	1,515	1,980	3,349	3,561	3,612
Nonfarm Tractors and Parts	1,007	1,366	1,633	1,129	1,092

(continued)

Table 46: U.S. Exports by End-Use Category, 1987-1991 (continued)

(in millions of dollars, f.a.s. value)

	1987	1988	1989	1990	1991
Industrial Engines, Pumps, Compressors and Generators	$3,008	$3,805	$5,954	$6,427	$7,658
Food and Tobacco Processing Machinery	563	685	1,214	1,251	1,403
Machine Tools, Metalworking, Molding and Rolling Mill Machinery	2,125	2,544	3,115	3,128	3,093
Textile and Sewing Machinery	556	705	1,036	1,038	1,024
Woodworking, Glassmaking and Plastic and Rubber Molding Machinery	1,140	1,473	1,417	1,485	1,475
Pulp, Paper, Printing and Packaging Machinery	1,278	1,682	2,039	2,251	2,319
Measuring, Testing and Control Instruments	4,366	5,282	5,402	5,760	6,016
Materials Handling Equipment	1,159	1,538	2,199	2,389	2,525
Photo and Service Industry Machinery	1,877	2,380	3,475	3,558	3,772
Agricultural Machinery and Equipment	1,914	2,377	2,262	2,377	2,243
Computers	4,240	5,372	7,729	7,950	8,017
Computer Peripherals, Accessories and Parts	14,279	18,059	16,747	17,939	19,238
Semiconductors	6,399	8,749	11,795	13,324	14,340
Telecommunications Equipment	5,017	6,337	8,193	9,342	10,309
Other Office and Business Machines	1,612	1,724	2,231	2,136	2,485
Scientific, Hospital and Medical Equipment	4,158	5,248	6,963	7,718	9,003
Transportation Equipment	17,828	22,691	28,233	33,767	38,088
Civilian Aircraft	7,657	10,431	13,711	18,402	22,622
Parts for Civilian Aircraft	4,776	5,588	6,834	7,567	7,479
Engines for Civilian Aircraft	3,772	4,865	6,078	6,214	6,360
Marine Engines and Parts	1,180	1,232	779	651	700
Automotive Vehicles, Parts and Engines	25,739	30,208	34,940	36,503	40,140
Cars	7,359	9,014	10,799	10,538	11,999
Trucks, Buses and Special Vehicles	3,771	3,986	3,405	4,229	5,393
Automotive Engines and Parts	2,834	3,346	4,426	4,180	4,700
Other Automotive Parts and Accessories (incl. tires)	11,776	13,863	16,310	17,556	18,049
Consumer Goods	19,758	26,000	36,565	42,779	45,857
Manufactured Consumer Nondurables	10,531	13,138	16,625	19,665	21,914
Textile Apparel, Footwear and Household Goods	1,303	1,682	2,220	2,636	3,423
Pharmaceutical Preparations	3,450	4,244	4,439	4,834	5,379
Printed Material	1,532	1,873	2,538	2,852	3,196
Toiletries and Cosmetics	424	522	868	1,143	1,484
Cigarettes and Other Tobacco Manufactures	2,319	2,926	3,677	5,041	4,588
Manufactured Consumer Durables	8,068	11,352	18,172	21,118	21,992
Household and Kitchen Appliances	1,003	1,476	2,473	2,613	3,041
Pleasure Boats and Motors	604	877	1,164	1,269	1,233
Toys, Sporting Goods, Bicycles and Motorcycles	946	1,367	2,415	2,871	3,470
Records, Tapes and Disks	547	793	1,411	1,892	2,232
Artwork and Antiques	1,247	1,876	3,807	4,593	2,871
Unmanufactured Consumer Goods	1,159	1,511	1,768	1,996	1,952
Gemstones	1,090	1,425	1,590	1,795	1,735
Other Exports	25,173	31,286	17,163	21,656	24,164

Source: Department of Commerce

Table 47: U.S. Imports by End-Use Category, 1987-1991

(in millions of dollars, Customs value)

	1987	1988	1989	1990	1991
Total Imports	$406,283	$441,926	$473,112	$495,200	$487,083
Food, Feed and Beverages	24,809	24,930	25,077	26,653	26,468
Coffee	2,710	2,284	2,273	1,766	1,738
Meat and Meat Products	3,306	3,475	3,312	4,019	3,960
Fish and Fish Products	5,591	5,422	5,405	5,207	5,651
Fruits and Fruit Products	2,843	3,089	2,995	3,390	3,105
Vegetables and Vegetable Products	1,197	1,232	1,727	1,932	1,792
Wine	1,916	1,906	1,799	1,865	1,773
Other Alcoholic Beverages	1,356	1,504	1,590	1,730	1,595
Industrial Supplies and Materials	110,665	118,064	132,399	143,410	130,915
Crude Oil	29,453	25,805	35,527	43,948	36,848
Fuel Oil	5,989	5,945	6,449	8,037	5,834
Other Petroleum Products	5,610	5,777	6,258	7,104	5,762
Liquefied Petroleum Gas	1,930	1,888	2,187	3,221	2,703
Natural Gas	1,715	1,876	1,855	2,332	2,443
Logs and Lumber	3,133	3,030	3,072	2,727	2,697
Paper Base Stocks	2,131	2,734	3,063	2,868	2,164
Newsprint	4,121	4,512	4,545	4,324	4,101
Other Paper and Paper Products	2,417	2,965	2,025	2,280	2,185
Cotton Fibers, Yarn and Fabric	1,554	1,218	1,260	1,290	1,481
Synthetic Fibers, Yarn and Fabric	1,920	1,977	1,979	2,110	2,377
Plastic Materials	2,023	2,414	2,734	3,118	3,126
Fertilizers, Pesticides and Insecticides	1,613	2,140	1,960	1,848	1,892
Industrial Inorganic Chemicals	1,071	1,293	1,970	1,965	1,938
Industrial Organic Chemicals	3,627	4,738	4,690	5,100	5,384
Iron Ore, Steel Scrap and Ferroalloys	1,277	1,921	1,926	1,796	1,610
Steel Slabs, Bars, Wire Rods, Plates and Sheets	5,635	6,343	6,335	6,017	5,479
Steel Strip, Wire, Shapes, Pipes, Tubes and Fasteners	3,398	4,067	3,277	2,882	2,514
Fabricated Steel Products	1,789	2,177	2,370	2,296	2,118
Bauxite and Aluminum	2,981	3,669	3,735	3,525	3,152
Copper	1,002	1,522	1,575	1,425	1,193
Nonmonetary Gold	1,651	1,285	1,517	1,104	1,948
Other Precious Metals	1,889	2,026	2,167	2,522	2,342
Fabricated Nonferrous Metal Products	2,828	3,609	3,558	3,454	3,048
Blank Audio and Video Tapes and Other Media	1,307	1,356	1,420	1,484	1,685
Capital Goods	84,769	101,787	112,454	116,040	120,836
Electric Machinery	9,518	11,540	11,480	12,784	12,924
Generators, Transformers and Accessories	2,740	3,581	2,370	2,599	2,751
Other Electric Apparatus and Parts	6,778	7,959	9,109	10,186	10,173
Nonelectric Machinery	67,890	82,002	90,058	91,760	95,088
Excavating, Paving and Construction Machinery	1,539	1,668	1,966	1,867	1,196
Industrial Engines, Pumps, Compressors and Generators	3,215	3,963	4,316	4,582	4,600
Machine Tools, Metalworking, Molding and Rolling Mill Machinery	3,320	3,687	4,213	4,063	4,099
Textile and Sewing Machinery	1,380	1,657	1,765	1,814	1,545
Woodworking, Glassmaking and Plastic and Rubber Molding Machinery	1,708	2,052	2,304	2,303	2,409

(continued)

Table 47: U.S. Imports by End-Use Category, 1987-1991 (continued)

(in millions of dollars, Customs value)

	1987	1988	1989	1990	1991
Pulp, Paper, Printing and Packaging Machinery	$2,211	$2,468	$2,768	$2,587	$2,450
Measuring, Testing and Control Instruments	2,471	2,944	2,588	2,589	2,789
Materials Handling Equipment	1,811	1,922	2,339	2,043	1,770
Photo and Service Industry Machinery	2,674	2,772	3,230	3,171	3,216
Agricultural Machinery and Equipment	2,153	2,519	2,673	2,994	2,271
Computers	2,258	2,994	3,367	2,950	4,433
Computer Peripherals, Accessories and Parts	12,581	15,334	18,190	20,071	21,678
Semiconductors	7,783	10,963	12,330	12,169	13,084
Telecommunications Equipment	8,129	9,407	9,519	9,402	9,826
Other Office and Business Machines	3,605	4,134	4,436	4,153	4,197
Scientific, Hospital and Medical Equipment	2,951	3,406	4,291	5,040	5,436
Transportation Equipment	7,361	8,245	10,916	11,496	12,824
Civilian Aircraft	2,080	2,713	2,927	2,708	3,389
Parts for Civilian Aircraft	2,249	2,515	2,679	3,072	3,483
Engines for Civilian Aircraft	2,248	2,344	4,014	4,706	4,965
Automotive Vehicles, Parts and Engines	85,174	87,948	87,379	87,694	84,950
Cars	47,923	47,053	44,478	45,909	45,585
Trucks, Buses and Special Vehicles	9,150	8,317	9,417	9,214	8,877
Bodies and Chassis for Trucks and Buses	1,593	2,030	1,104	390	316
Automotive Engines and Engine Parts	5,416	6,536	7,707	7,130	6,455
Automotive Tires and Tubes	1,928	2,067	2,433	2,127	1,835
Other Automotive Parts and Accessories	19,164	21,945	22,440	22,924	21,882
Consumer Goods	88,824	96,424	102,262	105,294	108,025
Manufactured Consumer Nondurables	39,432	43,117	46,309	49,082	50,636
Cotton Apparel and Household Goods	8,078	8,383	9,269	10,156	10,709
Wool Apparel and Household Goods	1,595	1,668	1,569	1,475	1,486
Other Textile Apparel and Household Goods	10,619	10,723	11,626	12,156	12,368
Nontextile Apparel and Household Goods	3,131	3,805	3,930	3,663	3,616
Footwear	5,558	5,904	5,973	6,626	6,574
Sporting and Camping Apparel, Footwear and Gear	2,063	2,567	3,600	4,131	4,286
Pharmaceutical Preparations	2,703	3,497	3,411	3,676	4,687
Printed Material	1,393	1,495	1,507	1,546	1,581
Manufactured Consumer Durables	44,894	47,763	49,949	50,517	51,649
Furniture and Household Items	4,423	4,606	3,880	4,044	3,985
Glassware and Chinaware	1,940	2,006	1,277	1,306	1,316
Cookware, Cutlery, House and Garden Wares and Tools	1,890	2,087	1,895	1,880	1,937
Household and Kitchen Appliances	3,352	3,638	3,932	3,902	3,858
Toys and Sporting Goods (incl. bicycles)	7,196	7,985	8,885	9,743	9,410
Photographic and Optical Equipment	1,539	1,479	1,428	1,319	1,467
Television Sets and Other Video Equipment	6,410	5,824	6,862	6,380	6,661
Radios, Stereo Equipment and Other Audio Equipment	4,551	5,413	5,350	5,015	5,613
Jewelry and Watches	4,188	4,533	3,518	4,079	4,531
Artworks and Antiques	1,582	1,768	2,845	2,997	2,716
Unmanufactured Consumer Goods	4,499	5,544	6,005	5,695	5,740
Gem Diamonds	3,428	4,296	4,346	3,976	4,003
Other Imports	12,042	12,775	13,541	16,109	15,890

Source: Department of Commerce

Table 48: U.S. Trade with Japan, 1987-1991*

(in millions of dollars, seasonally unadjusted)

		Exports (f.a.s.)	Change Over Year-Earlier Period	Imports (Customs)	Change Over Year-Earlier Period	Trade Balance
1987		$28,249	5.1%	$84,575	3.3%	$-56,326
1988		37,725	33.5	89,519	5.8	-51,794
1989		44,494	17.9	93,553	4.5	-49,059
1990		48,580	9.2	89,684	-4.1	-41,105
1991		48,125	-0.9	91,511	2.0	-43,385
1990	January	4,028	28.9	6,878	2.2	-2,850
	February	3,784	16.1	6,911	-11.0	-3,128
	March	4,236	3.2	7,808	-7.5	-3,571
	April	3,598	-2.2	7,641	1.4	-4,043
	May	3,676	1.8	6,751	-14.8	-3,076
	June	4,178	2.6	7,220	-8.3	-3,043
	July	4,208	8.9	7,251	-7.7	-3,043
	August	3,889	-0.7	7,629	-2.9	-3,741
	September	4,000	14.2	7,023	-9.3	-3,023
	October	4,279	15.7	8,721	1.4	-4,442
	November	4,395	16.9	8,106	4.3	-3,711
	December	4,310	10.4	7,745	4.0	-3,435
1991	January	3,806	-5.5	7,344	6.8	-3,539
	February	4,267	12.8	7,420	7.4	-3,154
	March	4,260	0.6	7,925	1.5	-3,665
	April	3,926	9.1	7,179	-6.0	-3,253
	May	4,228	15.0	6,711	-0.6	-2,484
	June	3,976	-4.8	6,997	-3.1	-3,021
	July	3,862	-8.2	7,659	5.6	-3,797
	August	4,039	3.9	7,790	2.1	-3,751
	September	3,620	-9.5	7,794	11.0	-4,174
	October	4,267	-0.3	8,884	1.9	-4,617
	November	4,324	-1.6	7,771	-4.1	-3,447
	December	3,553	-17.6	8,037	3.8	-4,485

*The export and import data reflect revisions not necessarily incorporated in Table 49 and Table 50. The export statistics cover domestic and foreign merchandise, including Department of Defense shipments.

Source: Department of Commerce

Table 49: U.S. Exports to Japan by End-Use Category, 1987-1991

(in millions of dollars, f.a.s. value)

	1987	1988	1989	1990	1991
Total Exports to Japan	$28,284	$37,732	$44,489	$48,580	$48,118
Food, Feed and Beverages	5,614	8,005	8,430	8,502	8,617
Wheat	350	426	477	421	422
Corn	1,024	1,611	1,597	1,673	1,540
Sorghum, Barley and Oats	181	233	351	316	185
Other Animal Feeds	228	326	277	286	363
Soybeans	782	1,033	866	818	865
Other Oilseeds	39	58	56	64	62
Meat and Meat Products	910	1,379	1,630	1,578	1,600
Dairy Products and Eggs	45	56	36	45	68
Fish and Fish Products	1,070	1,582	1,625	1,801	1,890
Fruits and Fruit Products	449	535	580	543	628
Vegetables and Vegetable Products	190	267	275	290	314
Nuts and Nut Products	105	122	124	116	115
Bakery and Confectionery Products	46	86	87	79	66
Wine	25	41	57	81	77
Other Alcoholic Beverages	49	105	110	130	142
Industrial Supplies and Materials	10,386	13,157	15,556	15,236	14,845
Raw Cotton	423	482	547	579	483
Unmanufactured Tobacco	302	213	297	305	220
Hides and Skins (incl. furskins)	380	467	408	457	282
Metallurgical-Grade Coal	443	525	503	510	428
Other Coal	43	77	452	463	563
Fuel Oil	409	349	239	164	155
Other Petroleum Products	337	404	527	595	383
Natural Gas	149	154	158	162	237
Nuclear Fuel Materials and Fuels	526	476	791	662	774
Logs, Lumber, Plywood and Veneers	1,584	1,928	2,393	2,312	2,047
Manufactured Wood Supplies	29	46	81	109	99
Paper Base Stocks	760	1,057	993	778	702
Newsprint and Other Paper Products	389	459	514	489	489
Cotton and Other Natural Fibers, Yarn and Fabric	29	42	51	51	41
Synthetic Fibers, Yarn and Fabric	59	91	108	107	116
Synthetic Rubber	70	80	52	51	57
Plastic Materials	385	498	446	450	522
Fertilizers, Pesticides and Insecticides	298	295	267	274	323
Industrial Inorganic Chemicals	167	232	281	247	255
Industrial Organic Chemicals	689	908	1,003	987	1,044
Iron Ore, Steel Scrap and Ferroalloys	125	163	184	164	142
Steel Slabs, Bars, Wire Rods, Plates and Sheets	18	92	224	145	208
Steel Strip, Wire, Shapes, Pipes, Tubes and Fasteners	36	57	44	67	65
Aluminum	662	1,180	1,505	1,334	1,372
Copper	192	377	556	639	565
Nonmonetary Gold	14	99	78	19	81
Other Precious Metals	115	195	177	199	195
Other Nonferrous Metals	202	318	295	315	287
Fabricated Metal Products	126	165	132	155	150

(continued)

Table 49: U.S. Exports to Japan by End-Use Category, 1987-1991 (continued)

(in millions of dollars, f.a.s. value)

	1987	1988	1989	1990	1991
Unmanufactured Nonmetallic Minerals	$148	$178	$110	$117	$153
Manufactured Mineral Supplies	91	105	290	319	321
Blank Audio and Video Tapes and Other Media	94	142	131	141	104
Capital Goods	7,762	10,716	12,152	14,433	15,140
Electric Machinery	513	681	669	712	826
Generators, Transformers and Accessories	64	95	96	144	120
Other Electric Apparatus and Parts	449	587	573	567	706
Nonelectric Machinery	5,277	7,667	9,664	10,361	11,257
Excavating, Paving and Construction Machinery	40	69	127	143	116
Nonfarm Tractors and Parts	67	110	99	105	85
Industrial Engines, Pumps, Compressors and Generators	129	166	267	306	369
Food and Tobacco Processing Machinery	35	41	75	75	86
Machine Tools, Metalworking, Molding and Rolling Mill Machinery	145	216	244	240	261
Textile and Sewing Machinery	25	41	60	56	52
Woodworking, Glassmaking and Plastic and Rubber Molding Machinery	46	70	57	76	66
Pulp, Paper, Printing and Packaging Machinery	81	124	122	134	141
Measuring, Testing and Control Instruments	580	842	775	739	725
Materials Handling Equipment	31	59	72	93	109
Photo and Service Industry Machinery	159	198	280	298	321
Agricultural Machinery and Equipment	33	47	74	81	70
Computers	504	803	1,247	1,320	1,273
Computer Peripherals, Accessories and Parts	1,225	1,743	1,859	2,245	2,351
Semiconductors	550	841	1,172	1,297	1,490
Telecommunications Equipment	456	621	978	974	1,129
Other Office and Business Machines	124	102	192	148	156
Scientific, Hospital and Medical Equipment	578	775	1,068	1,113	1,320
Transportation Equipment	1,971	2,368	1,819	3,360	3,057
Civilian Aircraft	1,100	1,306	720	2,178	1,923
Parts for Civilian Aircraft	456	523	608	675	658
Engines for Civilian Aircraft	311	430	374	418	384
Marine Engines and Parts	93	92	71	60	74
Automotive Vehicles, Parts and Engines	406	826	1,126	1,759	1,485
Cars	111	348	481	869	661
Trucks, Buses and Special Vehicles	20	46	66	127	98
Automotive Tires and Tubes	62	147	179	179	164
Automotive Parts and Accessories (incl. engines)	213	285	400	584	562
Consumer Goods	2,788	3,701	5,620	6,902	6,143
Manufactured Consumer Nondurables	1,630	2,010	2,465	2,972	3,282
Textile Apparel, Footwear and Household Goods	76	136	183	270	395
Nontextile Apparel, Footwear and Household Goods	61	77	109	98	109
Sporting and Camping Apparel, Footwear and Gear	59	60	27	43	53
Pharmaceutical Preparations	701	849	875	805	870
Printed Material	77	105	137	146	147

(continued)

Table 49: U.S. Exports to Japan by End-Use Category, 1987-1991 (continued)

(in millions of dollars, f.a.s. value)

	1987	1988	1989	1990	1991
Toiletries and Cosmetics	$49	$40	$66	$82	$146
Cigarettes and Other Tobacco Manufactures	495	614	874	1,315	1,355
Manufactured Consumer Durables	996	1,460	2,928	3,623	2,639
Furniture	23	37	54	56	70
Cookware, Cutlery, House and Garden Wares and Tools	56	39	60	53	67
Household and Kitchen Appliances	29	35	99	93	110
Floor Coverings	21	37	61	52	44
Pleasure Boats and Motors	31	56	97	182	134
Toys, Sporting Goods, Bicycles and Motorcycles	185	286	464	473	492
Musical Instruments and Photographic and Optical Equipment	60	75	104	98	106
Television Sets and Other Video Equipment	14	30	63	57	77
Radios, Stereo Equipment and Other Audio Equipment	7	16	63	65	58
Records, Tapes and Disks	70	121	220	261	302
Jewelry and Watches	67	89	153	229	242
Artwork and Antiques	310	499	1,258	1,746	624
Unmanufactured Consumer Goods	163	231	227	308	222
Gemstones	158	226	220	300	213
Other Exports	1,329	1,326	1,605	1,748	1,888
Military Equipment and Supplies	440	302	1,014	978	1,041
Military Aircraft	437	301	93	87	49
Engines for Military Aircraft	n.a.	n.a.	131	144	148
Tanks, Artillery and Missiles	3	0	241	155	253

Source: Department of Commerce

Table 50: U.S. Imports from Japan by End-Use Category, 1987-1991

(in millions of dollars, Customs value)

	1987	1988	1989	1990	1991
Total Imports from Japan	$84,592	$89,762	$93,558	$89,612	$91,510
Food, Feed and Beverages	465	406	348	327	336
Fish and Fish Products	265	200	176	151	132
Industrial Supplies and Materials	7,987	8,495	8,527	8,470	8,477
Paper and Paper Products	155	174	184	187	181
Cotton Fibers, Yarn and Fabric	155	124	119	114	125
Synthetic Fibers, Yarn and Fabric	462	406	356	322	361
Plastic Materials	514	509	564	593	595
Fertilizers, Pesticides and Insecticides	22	27	51	65	71
Industrial Inorganic Chemicals	147	144	186	184	203
Industrial Organic Chemicals	652	720	703	630	688
Steel Slabs, Bars, Wire Rods, Plates and Sheets	1,524	1,584	1,675	1,457	1,292
Steel Strip, Wire, Shapes, Pipes, Tubes and Fasteners	712	841	684	571	508
Fabricated Steel Products	518	590	576	551	493
Fabricated Nonferrous Metal Products	513	444	434	559	450
Blank Audio and Video Tapes and Other Media	809	752	672	723	811
Capital Goods	27,697	32,834	36,644	34,361	36,030
Electric Machinery	2,853	3,468	3,152	3,278	3,270
Generators, Transformers and Accessories	634	807	411	451	470
Other Electric Apparatus and Parts	2,219	2,661	2,741	2,827	2,800
Nonelectric Machinery	24,324	28,810	32,718	30,424	31,968
Drilling and Oilfield Equipment	137	373	251	244	342
Specialized Mining and Oil Processing Equipment	525	563	479	517	339
Excavating, Paving and Construction Machinery	414	436	433	483	245
Nonfarm Tractors and Parts	83	105	269	104	118
Industrial Engines, Pumps, Compressors and Generators	905	1,140	1,164	1,248	1,194
Food and Tobacco Processing Machinery	118	94	76	81	64
Machine Tools, Metalworking, Molding and Rolling Mill Machinery	1,505	1,742	2,090	1,674	1,821
Textile and Sewing Machinery	292	403	523	409	411
Woodworking, Glassmaking and Plastic and Rubber Molding Machinery	478	557	795	625	802
Pulp, Paper, Printing and Packaging Machinery	328	348	472	448	463
Measuring, Testing and Control Instruments	674	818	807	780	849
Materials Handling Equipment	587	524	650	459	368
Photo and Service Industry Machinery	923	988	1,269	1,121	1,116
Agricultural Machinery and Equipment	550	494	438	403	351
Computers	617	648	619	469	731
Computer Peripherals, Accessories and Parts	5,768	7,050	7,936	8,110	8,664
Semiconductors	1,965	3,278	3,877	3,299	3,661
Telecommunications Equipment	3,647	3,851	4,620	4,100	4,175
Other Office and Business Machines	2,446	2,511	2,549	2,371	2,418
Scientific, Hospital and Medical Equipment	867	984	1,240	1,428	1,526

(continued)

Table 50: U.S. Imports from Japan by End-Use Category, 1987-1991 (continued)

(in millions of dollars, Customs value)

	1987	1988	1989	1990	1991
Transportation Equipment	$519	$557	$774	$659	$793
Parts for Civilian Aircraft	255	322	384	467	575
Engines for Civilian Aircraft	35	58	97	60	70
Railroad Equipment	134	89	72	46	59
Marine Engines and Parts	55	63	180	85	88
Automotive Vehicles, Parts and Engines	33,690	32,789	34,017	32,207	32,829
Cars	21,273	19,873	20,140	19,525	20,666
Trucks, Buses and Special Vehicles	4,726	3,477	2,855	1,966	1,979
Bodies and Chassis for Trucks and Buses	226	263	86	47	34
Automotive Engines and Engine Parts	1,405	2,011	3,054	2,683	2,524
Automotive Tires and Tubes	498	641	818	666	524
Other Automotive Parts and Accessories	5,562	6,525	7,064	7,321	7,101
Consumer Goods	13,940	14,252	12,961	12,891	12,477
Manufactured Consumer Nondurables	1,400	1,450	1,541	1,372	1,439
Cotton Apparel and Household Goods	182	112	69	52	36
Other Textile Apparel and Household Goods	215	203	150	95	85
Nontextile Apparel and Household Goods	47	43	87	96	116
Pharmaceutical Preparations	336	344	347	343	454
Printed Material	194	218	191	186	165
Manufactured Consumer Durables	12,400	12,642	11,350	11,429	10,963
Glassware and Chinaware	375	333	275	262	256
Cookware, Cutlery, House and Garden Wares and Tools	209	209	190	168	178
Household and Kitchen Appliances	737	625	597	646	492
Motorcycles and Parts	556	629	586	403	552
Pleasure Boats and Motors	322	447	213	216	209
Toys and Sporting Goods (incl. bicycles)	931	1,633	2,123	2,632	1,922
Photographic and Optical Equipment	1,079	952	804	716	756
Musical Instruments and Other Recreational Equipment	544	549	393	350	341
Television Sets and Other Video Equipment	3,608	2,810	3,241	2,994	2,835
Radios, Stereo Equipment and Other Audio Equipment	2,754	3,223	1,968	1,946	2,105
Jewelry and Watches	526	556	356	436	578
Artworks and Antiques	63	43	101	123	147
Unmanufactured Consumer Goods	139	161	70	90	75
Other Imports	814	985	1,061	1,355	1,361

Source: Department of Commerce

Table 51: U.S. Direct Investment Position Abroad, Yearend 1987-1991

(in millions of dollars, historical cost basis)

	1987	1988	1989	1990	1991
Developed Countries	$237,508	$252,649	$278,309	$318,156	$335,433
Canada	57,783	62,656	63,919	67,033	68,510
United Kingdom	44,512	49,459	61,156	68,224	68,261
West Germany	24,388	21,832	23,261	27,259	32,942
Switzerland	19,665	18,734	23,488	25,199	26,443
Netherlands	14,842	16,145	17,264	22,658	24,711
Japan	15,684	18,009	18,800	20,997	22,918
France	11,868	13,041	15,143	18,874	20,495
Australia	11,363	12,823	13,728	14,846	15,627
Italy	9,264	9,496	9,970	13,117	13,825
Belgium	7,267	7,501	7,797	9,050	8,838
Spain	4,076	4,966	6,177	7,704	7,712
Ireland	5,425	5,886	5,492	6,880	7,450
Norway	3,843	4,371	3,459	3,815	4,248
New Zealand	743	833	1,114	3,131	2,809
Developing Countries	73,017	80,060	90,374	102,360	111,608
Bermuda	19,215	19,022	19,954	21,737	20,737
Brazil	10,951	12,609	14,733	14,918	15,222
Mexico	4,913	5,712	7,341	9,398	11,570
Panama	6,622	6,874	6,744	7,409	10,980
Hong Kong	4,389	5,240	5,873	6,187	6,430
Singapore	2,384	2,311	2,549	3,385	4,313
Indonesia	3,070	2,921	2,850	3,226	3,458
Argentina	2,744	2,597	2,604	2,956	3,412
Bahamas	3,814	4,112	3,776	3,309	3,319
Netherlands Antilles	-14,235	-9,983	-6,729	-2,229	-3,568
International	3,782	3,184	3,737	3,570	3,155
Total	314,307	335,893	372,419	424,086	450,196
of which:					
Petroleum	59,774	57,807	51,393	56,957	59,160
Manufacturing	131,645	138,725	144,679	164,466	175,413
Wholesale Trade	31,847	34,054	35,319	38,217	43,218
Banking	18,027	19,109	19,077	19,783	18,756
Finance, Insurance and Real Estate	53,046	63,386	96,828	112,374	117,094
Services	6,706	7,869	9,222	11,401	13,368
Other	13,262	14,942	15,900	20,888	23,187

Source: Department of Commerce

Table 52: U.S. Direct Investment Position in Japan, Yearend 1987-1991

(in millions of dollars, historical cost basis)

	1987	1988	1989	1990	1991
Total	$15,684	$18,009	$18,800	$20,997	$22,91
Petroleum	2,642	3,443	3,684	3,800	4,19
Manufacturing	8,107	8,929	9,092	9,910	10,43
Food Products	371	334	310	394	434
Chemicals	2,159	2,423	2,304	2,513	2,934
Metals	175	187	167	213	201
Electric Machinery	744	1,070	1,178	1,228	1,26
Nonelectric Machinery	*	2,775	2,683	2,936	*
Transport Equipment	1,231	1,286	1,662	1,819	1,66
Other	*	854	788	806	*
Wholesale Trade	2,933	3,485	3,584	3,969	4,851
Banking	333	263	142	222	30
Finance, Insurance and Real Estate	1,231	1,298	1,613	2,343	2,55
Services	157	224	405	328	401
Other	281	366	278	425	44

*Suppressed to avoid disclosure of data on individual companies.

Source: Department of Commerce

Table 53: Foreign Direct Investment Position in the United States, Yearend 1987-1991

(in millions of dollars, historical cost basis)

	1987	1988	1989	1990	1991
United Kingdom	$75,519	$95,698	$103,458	$102,790	$106,064
Japan	34,421	51,126	67,268	81,775	86,658
Netherlands	46,636	48,128	56,734	63,938	63,848
Canada	24,684	26,566	30,370	30,037	30,022
West Germany	21,905	25,250	28,386	28,309	28,171
France	10,137	13,233	15,365	18,665	22,740
Switzerland	13,772	14,372	18,746	17,745	17,594
Netherlands Antilles	8,062	8,935	8,733	12,584	7,948
Australia	5,369	7,171	4,962	6,539	6,626
Sweden	4,910	4,713	5,535	5,467	5,597
Panama	2,627	2,878	3,392	4,099	4,367
Belgium	3,371	3,471	3,799	3,866	3,653
Kuwait	3,898	3,954	4,280	1,831	2,000
OPEC Countries	4,658	6,487	8,067	4,246	4,275
Total	263,394	314,754	368,924	396,702	407,577
of which:					
Petroleum	37,815	36,006	40,345	42,165	39,955
Manufacturing	93,865	122,582	150,949	157,431	162,853
Wholesale Trade	37,427	43,725	45,456	50,750	52,962
Retail Trade	7,972	9,865	8,549	8,877	6,730
Banking	14,354	16,906	18,431	18,731	20,655
Finance	7,389	8,113	18,657	10,129	9,196
Insurance	17,712	18,991	22,509	24,922	33,306
Real Estate	22,025	25,867	30,386	34,552	33,747
Other	24,837	32,699	33,641	49,144	48,173

Source: Department of Commerce

Table 54: Japan's Foreign Direct Investment Position in the United States, Yearend 1987-1991

(in millions of dollars, historical cost basis)

	1987	1988	1989	1990	1991
Total	$34,421	$51,126	$67,268	$81,775	$86,658
Petroleum	-56	-64	-122	11	113
Manufacturing	4,970	11,065	15,601	17,153	18,657
Food Products	281	393	678	793	769
Chemicals	932	1,677	2,350	3,101	3,446
Metals	602	1,293	2,527	2,326	2,504
Machinery	1,686	2,930	3,943	5,203	5,396
Other	1,469	4,772	6,101	5,730	6,542
Wholesale Trade	15,927	18,462	21,111	25,750	26,935
Retail Trade	373	411	571	639	1,102
Banking	3,655	4,367	4,963	5,931	6,797
Finance	2,994	5,666	9,291	8,605	9,120
Insurance	188	266	368	388	572
Real Estate	4,386	8,190	10,665	15,084	14,948
Services	1,603	2,314	4,043	7,393	7,574
Other	381	449	779	820	839

Source: Department of Commerce

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REPORT

A Two-Part Report: A and B

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JAPAN'S GROWING ROLE IN U.S. RESEARCH: BANE OR BOON?

Summary

The growth in foreign financial support of U.S. research and development efforts over the past several years has featured increasing interest from Japan, including rising outlays by Japanese corporations. A continued, strong and comprehensive effort by Japanese companies to keep abreast of and tap into American research and innovation is another facet of the growing interdependence of the U.S. and Japanese economies.

This expanding Japanese presence has stimulated concern among some U.S. policymakers that Japanese companies not only are skimming the "cream" of American R&D but are doing so at U.S. taxpayers' expense. As developing new technology becomes an increasingly critical determinant of global competitiveness and more and more expensive as well, American policymakers are weighing the costs and benefits of their open-door policy on foreign access to U.S. R&D, particularly where tax dollars are involved.

Foreign Research In The United States

While most Americans today might think that the United States always has played a dominant role in scientific research and industrial innovation, this is not the case. Prior to World War II the United States was a net technology absorber, although Americans did make significant contributions to the warehouse of human knowledge. In the postwar period the United States was the only major power with its scientific resources, both human and physical, mainly intact and able to support civilian and military pursuits. In addition, many European scientists and engineers emigrated from war-torn countries to the United States, further bolstering the American postwar advantage in research and development.

Two U.S. traditions have played a major role in shaping foreigners' participation in American research and development:

- An open-door policy on scientific research - Wide dissemination and open discussion of scientific research widely is perceived as a key source of vitality for the U.S. research establishment. Publishing research results not only allows scientists to establish a reputation and win the plaudits of peers but gives others a chance to critique the results, a process aimed at leading to still better science. Open discussion of research also may trigger new ideas and approaches, which, in turn, can generate new research topics. The interplay between one branch of science borrowing research results and methods from another has led to big breakthroughs in the past and is growing more important as new technologies with wide applications are developed. Foreigners have been welcome as part of the U.S. research community and have contributed much to the rigor and vitality of scientific debate here.

- Easy access to U.S. universities for foreign students - The excellence of U.S. institutions of higher education long has been recognized abroad and consequently has attracted significant numbers of undergraduate and graduate students. American universities have welcomed foreign students not only because they add diversity to the student body but because their enrollment in some fields compensates for a dearth of American students. (Fees paid by foreign students also can be much higher than tuition charged Americans.)

Thus, in the postwar years at least, foreigners have been a constant feature of the American research community and have supported U.S. R&D with their labor and ideas. Many foreign science and engineering students have stayed in the United States after graduating, further bolstering U.S. technological resources. Until recently the role of foreigners in U.S. R&D has generated little comment or controversy. Two developments, however, ignited a debate over the wisdom of continuing this open-door policy.

Growing foreign financial support of U.S. research. Research spending by foreign-owned or controlled companies in the United States has been expanding not only in absolute amounts but relative to total U.S. R&D outlays, according to data collected by the Department of Commerce and analyzed by the National Science Board (see Table). Total foreign research spending in the United States grew from $933 million in 1977 to $7,382 million in 1988, the latest year for which data are available. From 1978 through 1982 foreign research outlays rose by more than 20 percent annually, peaking at growth of 59.8 percent in 1981. From 1983 through 1988 the increase in spending moderated but remained between 11 and 14 percent.

Growth in foreign spending outpaced the rate of expansion in overall U.S. research expenditures as shown by the rising share of foreign outlays, measured in current dollars. Beginning at 2.2 percent in 1977, foreign spending's share rose to 3.1 percent by 1980 and hit a plateau of 4.7 percent from 1982 to 1984 before rising again in the last half of the 1980s. While foreign spending still is a relatively small portion of the total spent on U.S. research, its faster pace of growth has raised eyebrows in industry, academia and government.

U.S technological leadership challenged. After rapidly rebuilding their war-torn economies the European countries and Japan are making a bid for technological parity or leadership in consumer and industrial products, in particular. While the Europeans have tended to specialize in a few fields or have developed a handful of globally competitive firms, Japan is challenging the United States across nearly the entire spectrum of manufacturing with many intensely competitive companies. The Japanese have attracted special attention in this area for several reasons.

- U.S. market penetration - Capitalizing on manufacturing cost advantages and rapid product innovation, Japanese firms have gained significant shares of important or highly visible American markets. Japanese products play big or leading roles in U.S. markets for cars, televisions,

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Foreign R&D Expenditures in the United States, 1977-1988

(in millions of dollars and percent)

a. versus total U.S. R&D expenditures

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
Total Expenditures	$42,783	$48,128	$54,953	$62,610	$71,868	$80,018	$89,139	$101,139	$113,818	$119,529	$125,352	$133,741
Foreign Expenditures	933	1,230	1,584	1,946	3,110	3,744	4,164	4,738	5,240	5,804	6,521	7,382
Share	2.2%	2.6%	2.9%	3.1%	4.3%	4.7%	4.7%	4.7%	4.6%	4.9%	5.2%	5.5%

b. by country

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
Japan	$23	$54	$77	$88	$142	$141	$171	$210	$267	$292	$307	$515
Canada	74	85	102	135	777	1,032	1,212	1,405	1,550	1,542	1,666	*
Europe	790	996	1,253	1,544	1,936	2,229	2,324	2,632	2,918	3,450	3,881	4,403
France	62	89	56	146	204	232	215	261	166	352	366	419
Germany	101	189	311	380	436	529	591	602	671	851	1,139	1,180
Netherlands	190	215	244	299	373	397	387	432	514	517	542	597
Sweden	10	12	14	36	53	54	62	63	116	141	128	162
Switzerland	241	287	352	338	416	447	463	546	625	744	765	898
United Kingdom	155	176	252	312	405	520	559	664	748	764	833	1,042
Other	31	28	24	33	49	50	47	64	78	81	108	105
Latin America	35	73	132	*	*	*	401	423	427	427	391	366
Other	11	22	20	*	*	*	56	68	78	93	276	*

*Data withheld to avoid disclosing operations of individual companies.

Source: National Science Board, *Science and Engineering Indicators, 1991*, pp. 306, 346.

audio and video equipment, telecommunications gear and industrial machinery; these were all areas in which the United States previously held sway.

- Dominance of "key" products - Japan's rapid accession to top ranking in the global market for computer memory chips and other electronic components met with disfavor among some American observers who saw it as a major threat to U.S. economic growth. While proving reliable and economic suppliers of high-quality products to both civilian and military sectors (see *JEI Report* No. 33A, August 28, 1992), Japanese computer chip makers have failed to leverage their control of various components into leadership of downstream products. Computer memory chip operations have consumed a growing portion of capital and research budgets without producing large profits. The Japanese oligopoly also has attracted — in true free-market fashion — new competitors, primarily South Korean companies. Thus, to date the "threat" has proved overblown.

- Growing investment in the United States - Japanese companies' purchases of minority or controlling shares in American high technology companies skyrocketed over the past decade. Thanks to the appreciation of the yen against the dollar and a flood of inexpensive capital during the second half of the 1980s, Japanese firms appeared to go on a buying spree in the United States. Besides large green-field manufacturing plants and high-visibility real estate assets, news accounts and private studies cited high technology start-up companies as prime targets of Japanese investment. Because many of these start-ups involve current or former university researchers, there has been some debate whether public funding of academic science translates into an indirect subsidy to foreign companies. It is not clear, however, whether these investments have led to significant transfers of technology to Japan or whether the benefits of Japanese investment outweigh any potential disadvantages.

Another aspect of the investment issue is the growing number of Japanese firms setting up research operations here or adding them to an existing U.S. presence. Many of these facilities are located near academic institutions with good R&D reputations or near hotbeds of industrial innovation with the clear goal of tapping into ongoing developments and the flow of information.

A third facet of this question is the growth of Japanese investment in academic research. Japanese corporations have endowed research chairs at American colleges and supported the construction of new research facilities. Universities with strong research capabilities often have industrial liaison programs specifically designed to enhance cooperation with the private sector on R&D. Not surprisingly, Japanese firms participate in these ILPs right alongside American and other foreign companies. Japanese firms also are active (just as American companies are) in hiring American academic researchers or forming commercial partnerships with them.

- Growing Japanese share of U.S. patents - Foreign applicants steadily are adding to their share of total American patents granted each year, with Japanese firms at the head of the list. In FY 1991 the U.S. Patent Office granted Japanese companies 21,464 out of a total of 101,860 patents or 21.1 percent. Germany was a distant second with 7,548 patents granted (7.4 percent). Furthermore, three Japanese companies, Toshiba Corp. (1,156), Hitachi, Ltd. (1,139) and Mitsubishi Electric Co., Ltd. (959), placed first, second and third, respectively, in the number of patents granted to individual companies. (Canon Inc. was sixth with 828.) Studies of the "quality" or significance of patents also indicate that Japanese filings in certain fields are increasingly important.[1]

- Lack of foreign success in Japan - Each of these Japanese success stories in the United States seemingly has a negative mirror image of American experiences in Japan. Until recently American companies were unsuccessful at penetrating high technology markets in Japan, much less dominating them. Although the United States does lead the list of foreign investors in Japan, opportunities for foreigners to buy control of Japanese companies at the leading edge of technology have been very few. Japan's patent system has a notorious reputation for lengthy patent processing periods and ineffective protection of intellectual property rights. These American problems serve only to highlight more starkly Japan's success.

Bane Or Boon?

When U.S. technological and industrial superiority was unquestioned, foreign participation in America's research community was not an issue. The relative decline of American scientific dominance, especially vis-a-vis Germany and Japan, plus the end of the Cold War have focused much attention on the factors that contribute to economic competitiveness, including R&D. In an era of intensifying global economic competition as well as limited government and private financial resources, Americans actively are debating the costs and benefits of a continued open-door policy on foreign access to U.S. science and technology resources. The main areas of concern can be summarized as:

- Is the United States becoming reliant on foreign support for R&D? While this clearly is not true in an overall sense, the concentration of foreign interest in specific, important fields is a concern.
- Are foreigners benefiting more from U.S. research than Americans? Are foreign firms somehow using their well-developed technology-gathering networks to get a jump on technologies developed in the United States?
- Are U.S. tax dollars subsidizing foreign research without adequate recompense? Washington supports research directly, with projects and grants, and indirectly via tax breaks for corporate R&D spending. Because foreign firms take full advantage of university and federal research, some Americans claim that taxpayers are subsidizing foreign competition.
- Should foreign firms be free to buy U.S. technological assets? The sensitivities that formerly concentrated on foreign investment in defense-related firms have shifted somewhat to the competitive impact of foreign investment in U.S. high technology.

All sides of the debate agree that the United States has built a wonderfully productive research system and that one ingredient of its productivity is openness, even to foreigners. The issue boils down to whether the benefits of this system still accrue mainly to domestic entities. If not, the question becomes how can Americans regain positive benefit balance.

Human Resources

The transfer of technology can take many forms, including trade in components and finished products, patent licensing and cooperative research. Most students of the subject concur that the most powerful form of technology transfer is the exchange of individual researchers. While technology can be accessed from writings or by knocking down products embodying the know-how, these are pale substitutes for the knowledge gained by hands-on development of technology: such knowledge often cannot be, or is not, written. This is a key reason, besides wanting to take advantage of top-flight U.S. research, that foreign companies send employees to work in American research facilities.

Data on this question are not abundant. According to the National Science Board, foreign students as a proportion of all science and engineering graduate students rose from 20.2 percent in 1983 to 25.6 percent in 1990.[2] The foreign share of just science students seeking master's degrees increased from 16.7 percent to 22 percent over the same period; the respective figures for engineering students were 29.6 percent and 34.9 percent. The picture changes when doctoral candidates in science and engineering are considered. In 1980 foreigners represented 4.3 percent of science candidates, 12.1 percent of engineering candidates and 5.4 percent for both fields combined. Ten years later, the respective figures were 4.4 percent, 7.7 percent and 5.1 percent. The drop-off in the foreign share of engineering doctorates appears to have been due to slow growth in the number of foreign candidates (299 in 1980 versus 376 in 1990) combined with strong growth in enrollments by Americans (1,255 versus 1,927, respectively).

Data specifically on Japanese researchers in the United States are even scarcer. According to the Ministry of Education, a total of 764 researchers receiving a government subsidy of some sort (either for all expenses or just travel expenses) were sent overseas for periods of six months or more in

1990. That number was more than double the 319 government-funded researchers who went abroad in 1970. Of 1990's total 527 were enrolled in science studies and 237 in literature. Another 415 researchers were sent abroad to attend conferences in 1990. Neither a breakdown of the number sent to the United States nor Japanese data on the number of company employees in American laboratories are available.

A 1988 General Accounting Office study indicated 3,597 foreign researchers were at work in 50 federal laboratories and another 2,080 were participating in research through education programs at these federal labs in FY 1986.[3] This compares with figures of 4,657 and 8,435, respectively, for American researchers that year. Thus 30.2 percent of the researchers at the U.S. federal laboratories included in the survey were foreigners at those facilities. Among all foreign researchers in the survey 758 were Japanese nationals (13.4 percent); researchers from the United Kingdom (448 or 7.9 percent) and the People's Republic of China (438 or 7.7 percent) were next most numerous. Of the 452 Japanese doing actual R&D and not here for study or teaching, 193 (42.7 percent) were from nonprofit organizations, 92 (20.4 percent) were from the Japanese government and 27 (6 percent) from the private sector. The most popular institution for Japanese researchers was the National Institutes of Health (394) followed by the Department of Energy (245). Within DOE the majority of Japanese researchers focused on energy subjects (191); the remainder worked on defense programs (54).

While far from comprehensive the above data do show that Japan contributes relatively significantly to the makeup of foreign researchers in the United States. The information on Japanese researchers at U.S. federal laboratories is particularly interesting, though dated, because it reveals Washington's relatively open foreign access policy. Critics complain that the paucity of data since the GAO study was conducted poses an obstacle to informed policymaking on U.S. R&D issues.

Government-Sponsored International Research Projects

In response to foreign pressures to boost contributions to global science and technology know-how the Japanese government is sponsoring research by foreign companies at overseas locations, among other activities. Tokyo also has extended a welcome mat to researchers from foreign universities, companies and government laboratories via a number of programs:

- Human Frontiers Science Program - Announced in 1986 by then Prime Minister Yasuhiro Nakasone, HFSP's goal is to explore basic biological functions of the mind and body. Tokyo originally proposed to put up at least half of the ¥1 trillion ($7.4 billion at ¥135=$1.00) cost and solicited the participation of foreign scientists not only as researchers but as project leaders as well. Another innovation was that the research could be conducted abroad in the facilities of the foreign scientists winning contracts. Since overcoming foreign suspicions about the program by setting up an independent foundation in Strasbourg, France for administrative purposes and by agreeing to foot most of the bill, Tokyo has handled a steadily growing number of funding applications. In FY 1989 it granted 29 of the 239 applications for research grants and 80 of the 202 applications for long-term fellowships. In FY 1990 the same number of research grant applications were received but 32 were granted; of the 348 fellowships sought, 104 were approved. In the fiscal year ending in March, 37 of 281 research grant requests were accepted and 128 of 499 fellowship applications were approved. A total of 77.5 percent of the long-term fellowships and 70 percent of the research grants in FY 1989 went to foreigners, shares that dropped in FY 1991 to 76.5 percent and 32.4 percent, respectively. American researchers and institutions have received about one-quarter of the funds awarded so far. Tokyo also is devoting more funding to HFSP. The sum of ¥1.2 billion ($8.9 million) in FY 1988 climbed to over ¥3.8 billion ($28.1 million) in FY 1992.

- High-Speed Civilian Transport - Beginning in the mid-1980s Tokyo actively sought foreign participation in government-industry R&D programs. While a few of the projects have involved Japanese subsidiaries of foreign firms, a few directly enlisted foreign companies doing work overseas. One such project was initiated in FY 1989 to develop a Mach-5 civilian transport aircraft. General Electric Co., the Pratt & Whitney division of United Technologies Corp., Britain's Rolls-Royce, and France's Snecma, are collaborating in the design of a complex combined-cycle turbojet-range engine for the hypersonic craft. Foreign firms are slated to receive about 25 percent of the ¥3.8 billion ($28.1 million) appropriated in FY 1992 for the project. This phase of the HSCT development is expected to last about eight years and cost ¥44 billion ($325.9 million). Work seems to have gotten off to a good start with the mid-February 1991 signing of contracts. According to Yuichiro Takanemai, former director of hypersonic projects for the Ministry of International Trade and Industry, "Foreign companies and governments are careful about technology transfer. It's just been one year but they're doing well, with a two-way flow of technology."[4] As the combined-cycle engine takes shape, testing and evaluation of various components will take place at U.S. facilities of the American participants. Foreign firms may win roles in follow-on projects to build and test actual flying prototypes.

- The latest MITI-sponsored project to attract foreign participation is aimed at developing industrial and medical robots less than 1 millimeter in size. A 10-year ¥25 billion ($185.2 million) micromachines project began with the fiscal year that started in April. Participants include Texas Instruments Inc., SR Robotics Corp. and SRI International Inc., with 24 Japanese companies and researchers from Australia's R.M.I.T. Victoria University of Technology. The first five-year phase will focus on manufacturing and processing the special materials required while the next five years will work on actual fabrication of working devices.

- Intelligent Manufacturing System - Initially suggested by MITI in late 1989, this project originally aimed to develop an integrated computer system to conceive, design, produce and distribute manufactured products. MITI hoped to provide two-thirds of the estimated ¥150 billion ($1.1 billion) cost of the 10-year project, with the remaining funds coming from other members of the Organization for Economic Cooperation and Development. Foreign companies and universities would be welcome to submit research proposals and conduct the work in their home facilities. Worried that IMS would lead to the erosion of the U.S. position in certain fields, Washington stepped in under the aegis of the 1988 bilateral science and technology agreement. Besides requesting that MITI solicit a consensus from American companies about the wisdom and the benefit of joining IMS, the Commerce Department asked that the ministry channel all discussions about the program through Commerce rather than engage in direct talks with U.S. firms. At the latest session of talks held in late July, the main topics were how to structure test cases for cooperation and how to manage intellectual property rights. Also being examined are how to balance costs, share benefits and determine control of test cases. One or more test cases will be picked from six topics: enterprise integration, global manufacturing, system component technologies, clean manufacturing, human and organizational aspects, and advanced materials processing. The test cases also will serve to develop guidelines on how to handle intellectual property rights to the results of joint research.

- Real-World Computing Project - This successor to Tokyo's Fifth Generation Computing Project still is in the formative stage but has encountered many of the same delays as IMS. Aiming to develop massively parallel computers using optoelectronic components that could be as flexible and powerful as the human brain, MITI sought foreign input during the feasibility study phase (see *JEI Report* No. 42A, November 8, 1991). By seeking foreign input one step earlier in the planning process than it did with IMS the ministry underscored the importance of foreign ideas in advanced computing, since much of the leading-edge research is being done outside of Japan. Precisely because American firms have a perceived edge in this field, however, Washington again made U.S. participation in RWCP a subject of government negotiations. After a year of discussion Washington has decided to limit U.S. participation in the project, for the time being, to developing equipment to test and evaluate optical computing components.

Tokyo has added funds for foreign research activities to its R&D policy pallette, but its efforts are still in the early stages and encountering difficulties. Nevertheless, the more open stance by the Japanese government counters some of the arguments raised by those who fear America's research doors serve only one-way traffic.

Company Research

While Japanese government actions are noteworthy, the activities of Japanese corporations have received greater attention for several reasons. Japan-based companies have developed broad technology-gathering operations in the United States and other countries, including ties with universities, businesses and foreign governments; this can present the appearance of predatory technology gathering, even industrial espionage. Moreover, in Japan leading-edge research is conducted primarily within Japanese companies, which generally neither welcome foreigners into their laboratories nor encourage information to flow freely out their doors. Unlike government efforts at two-way flows of information the corporate attitude raises questions of equal access. But most important, Japanese companies have built a fearsome reputation for rapidly translating basic and applied research, especially foreign research, into commercial products.

Most Japanese companies that export to the United States built some kind of representative presence here to support their trade. As trade evolved and deepened, many companies added research functions to existing operations. This "research" first took the form of market research or tried to find ways to adapt products to local market needs. Once manufacturers began to localize production, more concerted research efforts followed closely. In recent years a number of Japanese companies have begun doing scientific and engineering research in the United States, either by expanding the scope of existing research operations or building new dedicated facilities.

There are several reasons for this surge in "real" research by foreign firms in the United States. Scientific or technological expertise in specific fields often is narrowly concentrated geographically; taking advantage of specialized talent usually requires a local presence. One reason that Japanese managers give for the ability of Japanese firms to quickly move technology from the laboratory onto the factory floor is the close proximity of research facilities to production lines and the constant interchange of researchers and line workers. As stated above, corporate research labs tended to follow Japanese firms' development of localized production facilities. Finally, there has been a sharp increase in the number of cooperative research agreements between Japanese and American companies, reflecting the complexity and higher costs of advancing the state of the art.

According to an annual survey by the Japan External Trade Relations Organization, an arm of MITI, more than 360 Japanese companies conduct R&D activities in the United States.[5] While many of these firms station the R&D facilities close to their factories, some locate them to take advantage of strong research resources. Several Japanese pharmaceutical companies, for example, have laboratories in Maryland, close to the National Institutes of Health and Johns Hopkins University, both centers of top-flight biological research. Foreign R&D centers also are situated near leading U.S. universities or concentrations of high technology companies, such as the so-called Silicon Valley area in California.

Japanese research facilities in the United States are quite diverse in size, purpose and subject matter. This reflects not only the extent to which the U.S. and Japanese economies have become intertwined, but the degree to which Japanese companies are becoming globalized and the richness of American technology resources. While operations focusing on market research still dot JETRO's listing, most R&D operations focus on specific applied research, such as steel, drugs, electronics components and ceramics. Japanese automakers have upgraded their American exterior design studios to full engineering workshops. Some care is necessary in interpreting JETRO's list, however. Many of the research operations listed in Washington, D.C. focus primarily on intelligence gathering and maintaining links with the U.S. bureaucracy; little, if any, actual research is conducted in these offices.

The Department of Commerce has examined the implications for U.S. technology development of the growing number of U.S. subsidiaries of Japanese companies. Citing Bureau of Economic Analysis data, the study reports that research spending by all U.S. affiliates of Japanese firms more than doubled from 1988 to 1989, jumping from $307 million to $770 million.[6] Through the first half of 1991, the study revealed, 31 Japanese electronics firms opened 70 research centers. This is far higher than the 21 European-affiliated laboratories that have opened. The number of Japanese R&D units continues to grow. Not surprisingly, semiconductors is the most common field, comprising 13 operations. Computers and software, tied at 12 each, follow in number with telecommunications equipment firms having eight facilities and advanced television research five. The Commerce study warns about the difficulties of assessing the true impact of Japanese corporate research here. Among its stated caveats are: a portion of the research is directed at marketing or localizing existing products; a portion is for intelligence gathering; the definition of "research" may be different among Japanese firms as compared with American ones; and the size of research operations is not taken into account. The study also points out that neither the contribution nor the impact of research conducted by American companies that have been bought by Japanese firms was considered.

It is apparent from the JETRO and the Commerce surveys that the great majority of Japanese research in the United States is focused narrowly on commercializing technology. Within the past few years, however, several Japanese firms have opened facilities to explore more basic science and research. NEC Research Institute Inc. opened its Princeton, New Jersey doors in 1990, representing parent NEC Corp.'s plunge into the American basic science community. Built at a cost of about $32 million and supported by an annual budget of roughly $26 million, the institute has recruited about 45 American scientists from academia and businesses.[7] A five-person board of scientists selects and funds research projects, which means they — rather than the parent company — essentially exercise control. While research supposedly is undirected and emphasizes new, risky areas of inquiry, most current topics clearly relate to NEC's lines of business. Work on neural computers, artificial intelligence, fuzzy logic, superconductivity and optoelectronics all eventually could be embodied in NEC products. Ties with the parent company also are close. NEC equipment in the laboratory is common, and institute scientists often collaborate with NEC researchers in Japan. While research results are discussed openly and published, it is not clear how intellectual property rights are handled. If NEC has an exclusive right to license patents resulting from the institute's work, the institute's benefits that accrue to the United States clearly are reduced. Some would argue that by hiring away elite researchers from American universities and companies the institute also erodes the U.S. research base. The Americans at the institute strongly dispute this point, contending that they can do better and more science since they do not have to worry about funding. Americans and Japanese will be watching NEC's institute carefully in the coming years, weighing its benefits and costs.

Corporate Research Ties With Americans

Besides conducting research within their own organizations, Japanese companies cultivate ties with American scientists, ranging from those in corporate America to U.S. private and public universities as well as to connections with the federal government's research establishment. Because few technology resources are overlooked, critics have characterized this comprehensive effort as an "unfair" competitive tactic employed by Japanese companies. This perception overlooks the openness of the U.S. system in which much information is gleaned from public sources, allowing intelligence-gathering efforts to take place openly. This means that the Japanese companies are not receiving special treatment — American firms can (and do) operate exactly the same way.

Ties to U.S. government laboratories - Washington and Tokyo often have agreed in the past to pursue jointly some areas of research. One area of long-standing cooperation focuses on peaceful uses of nuclear power. The federal government understands that its vast research system could assist the competitiveness of the private sector and has several programs designed to foster the transfer of technology. Japanese firms have taken advantage of these opportunities, too, sometimes dwarfing the interest shown by American companies. Japanese-owned firms outnumbered their U.S. counterparts 25 to 1 when Oakridge National Laboratory experimented with an open-door policy in the mid-1980s; the policy was altered to prevent controversy from developing over the Japanese predominance.[8]

Two interrelated developments are forcing federal laboratories to open their doors even wider to the private sector. First, the end of the Cold War means that some defense-related research will be less vital. Washington's pledges to cut the number of U.S. nuclear weapons, for example, probably will lead to less money for research in this area. This situation leads to the second factor: declining R&D budgets for federal facilities that previously focused on defense. To address both these developments federal laboratories are changing their priorities, putting a greater premium on commercially useful technology. Federal labs hope that by boosting the competitiveness of American companies they themselves will continue to prove their value and support their claim to a piece of the budget pie.

It is almost certain that Japanese companies (either directly or through their U.S. subsidiaries) will avail themselves of the new open-door policy set by federal laboratories. Because the government facilities still are determining the structure and the limits of the new policy, it is not clear whether special provisions for foreign firms will be included. Federal laboratories certainly would not aid their own cause if they left themselves open to charges that they were assisting foreign competitors with U.S. tax dollars. Participation by foreign firms, however, could benefit the American economy not only through program fees but through technology and information exchanges. The cost/benefit analysis of such situations often is not made easily.

Ties to U.S. universities - The American taxpayer directly and indirectly funds a vast system of higher education that serves as a hothouse of scientific inquiry and technological innovation. American companies long have benefited from academic research in many forms: through research they have funded, the professors and the graduates they have hired, the published research results, the scientific conferences open to them, and the useful technology made available for them to license. Japanese firms have followed similar approaches in building ties to U.S. universities for both business and philanthropic reasons. Universities themselves have reached out to the private sector to foster the transfer of technology. Schools with strong research resources have established industrial liaison programs that give businesses a window into ongoing work for a price. While it is difficult to criticize Japanese firms from behaving exactly as American companies by tapping into the technology resources of the U.S. university system, two areas have received the bulk of attention.

- Japanese funding of university research - A 1988 GAO report estimated that foreign funds made up less than 1 percent of the total R&D budget of 134 public and private universities that participated in the study.[9] Of the $74.3 million in total foreign funds, Japan provided $9.5 million (12.8 percent), second only to West Germany, which was the source of $16.3 million (21.9 percent). Fifty-three universities reported receiving funds from Japanese sources in FY 1986, with four receiving the bulk: Texas A&M University (26 percent), Massachusetts Institute of Technology (23 percent), University of Wisconsin (14 percent) and University of Washington (4 percent). Interestingly, the GAO survey showed that geology departments received the most foreign funding ($16.4 million), followed by agriculture ($11.5 million), medicine ($8.4 million), civil engineering ($2.7 million) and chemistry ($2.6 million). Computer engineering ($1.1 million), materials engineering ($1.3 million) and electrical engineering ($0.7 million) fared more poorly than might have been expected. The GAO study concluded that foreign funding in FY 1986 constituted only a small part of total university research outlays. While most universities did not report special rules for handling foreign funds, "where there are differences, U.S. universities tend to place greater restrictions on foreign than on U.S. sponsors."[10]

Using data mandated by Section 1209 of the Higher Education Act of 1965, the Center for Public Integrity presents a more complex picture of Japanese funding channeled to American universities.[11] Section 1209 required institutions to report gifts or contracts with foreigners to the Secretary of Education from FY 1986 through FY 1989 if the sums totaled $250,000 or more within a calendar year. By comparing these reports with the institutions' annual reports on contributions the center found that some institutions were not disclosing all funds received from Japan in their annual reports on contributions. In fact, 10 universities did not list Japan as a contributor between 1986 and 1989 even though they had received $500,000 or more. The University of California at Irvine, for example, included no Japanese funds in its annual review but reported under Section 1209 having received $16.5 million. MIT also listed no Japanese funds in its public report but showed receiving more than $5.8 million in its report to the Department of Education. The top 13 institutions as ranked by their public disclosures of donations from Japanese sources listed only $6.8 million. In their reports to the government they disclosed an additional $46.2 million. The center's report does not delve into why these funds were not included in the public reports; most of the funds were used to build research facilities and other works that directly relate to the universities' research activities. Although the reporting requirement lapsed in 1989, the nonprofit Washington, D.C.-based public interest group asserts that American colleges received more than $175.7 million from Japanese sources, including firms, nonprofit groups or quasi-governmental organizations, through 1991.

Beyond the absolute amount of funding are questions regarding the conditions under which the money is provided. Policymakers' primary concern is whether universities are so desperate for funds that they will agree to conditions highly favorable to the donor company. Critics cite as examples of questionable contracts those deals where Japanese company researchers have access to university work but not vice versa, and to contracts that give Japanese firms first or exclusive rights to license the results of research. Universities retort that they are not violating any federal law and that it is not up to them to establish a national policy in this area. Each institution makes what it feels is the best bargain, especially since Japanese firms are more willing than American companies to fund research with uncertain commercial applications.

- **University Industrial Liaison Programs** - MIT was the first American university to create a framework that gives the private sector a "window on emerging technologies" under development by academia. MIT's program, established in 1948, features special symposia for corporate members, visits to university laboratories, meetings with faculty and university administrators, and updates on research of special interest to members. American companies pay an average of $33,000 annually to participate in MIT's program while foreign firms pay an average of $46,000.[12] Thirty-nine other U.S. universities with strong research resources have created industrial liaison programs. To attract additional Japanese members and to foster MIT's access to Japanese technology, the institute opened an office for industrial liaison programs in Tokyo in 1975. Only two other schools — the University of California at Berkeley (1988) and Carnegie-Mellon University (1990) — have taken a similar step.

The controversy over university ILPs revolves around two questions. Are foreign companies being subsidized by the American taxpayer through the government's vast support for university research, and are foreign companies benefiting more from ILPs than American firms? Critics argue that foreign ILP members benefit from the vast American investment in universities without paying for it. While membership fees cover some current research expenses, the cost of building the research infrastructure, both human and physical, is not reflected in the annual fee. In essence, critics argue, foreign members should pay a fee that reflects these previous investments.

On the second question, critics point to some ILPs that give members a preview of research results before they are published openly. Foreign members thus can become aware of a new technology before most American firms, which may pay taxes to support the school but are not ILP members. While the delay between preview and public announcement of research results might be only a few months, in some rapidly changing, highly competitive industries even this brief advance notice can be an advantage.

Among other questions being debated regarding Japanese funding of American university research and foreign participation in university liaison programs are: Should a reporting requirement like Section 1209 be reinstated or made permanent? Should there be special federal rules for foreign funding of university research? How is a U.S. subsidiary of a foreign firm classified for participation in ILPs — particularly if it pays U.S. taxes? More data and discussion are needed before these questions can be addressed intelligently and appropriate policies implemented.

Ties to U.S. companies - Licensing of patents held by foreign competitors is a mainstay of the competitive tactics of Japanese corporations. Because they were technologically behind after World

War II, Japanese firms reasoned that the most cost- and time-efficient way to catch up was to license foreign know-how. Aided by the bureaucracy and by foreign willingness, Japanese companies obtained licenses to basic technologies at much less cost than if they had had to develop them themselves. Patent licensing still constitutes the biggest channel for technology transfer between the United States and Japan, with the flow predominantly from the United States to Japan although the imbalance is shrinking. (See *JEI Report* No. 28A, July 24, 1992 for detailed data on patent licensing transactions.)

A rapidly developing phenomenon is joint research, in which American and Japanese companies form strategic alliances to spread the high cost of developing new technology, improve the chances of success (two approaches may be luckier than one), and limit the impact of failure. Moreover, sharing costs of one project can permit other research to be funded simultaneously. (For a discussion of research consortia, see *JEI Report* No. 21A, June 5, 1992.) Alliances in microelectronics, for example, are sprouting as the cost of chip plants and microchip process developments rise into the billions of dollars. The world's automotive industry, too, is restructuring as individual companies pick partners and form alliances.

Debate over research arrangements between Japanese and American firms echo some of those regarding ILPs. Are the benefits fairly distributed? Is the American taxpayer somehow subsidizing the deal? Will the transactions benefit the entire U.S. economy? Those concerned over the structure of joint research pacts worry that the Japanese use the lever of money to gain a disproportionate share of the benefits. Since the specific terms of each agreement vary, it is difficult to generalize. Because they are private contracts, imposing federal guidelines on joint research ventures with foreign firms probably would be inflexible and unwieldy. If an American company makes a bad deal, some economists would shrug and say that this is the free market in action. Critics of laissez-faire approaches counter that the technology assets involved in a commercial deal can be so important in some cases that federal involvement is necessary to safeguard the interests of the entire nation; the meanings of "important" and "safeguard," however, usually are left fuzzy.

In past years national defense issues have been the focal point of arguments about the potential negative impact of this micro/macro discontinuity. This discussion now is expanding to include U.S. commercial interests. In this context questions include whether the research would be conducted at all without Japanese participation. In some cases, the complementarity between U.S. and Japanese companies is a powerful argument in favor of cooperative research.

Ties to U.S. research consortia - American firms increasingly are joining forces to conduct research. In some instances the federal government lends a hand (or a buck). Sematech, a consortium of American companies committed to developing advanced semiconductor manufacturing technologies, is an example of how a foreign presence in American research can complicate the picture. Originally established in 1987 to answer the challenge of Japanese gains in semiconductor manufacturing equipment, Sematech relies on members to pool about $100 million a year for research. Washington agreed to match this commitment for the consortium's first five years. Since its inception Sematech has experienced controversies over its purchases of foreign equipment and its contracts with foreign-affiliated firms. Outside deals between foreign firms and individual Sematech members raised questions about the integrity of the consortium's proprietary technology. Rumors that the consortium was even considering joint research with foreign firms set off heated debate within the group as well as outside it. As strategic alliances become more widespread, as cooperative research becomes more common and as the Japanese and other foreign presence in the United States grows, controversies such as those experienced by Sematech will become increasingly common.

Japanese Direct Investment

Another long-standing phenomenon that has become increasingly controversial is the purchase of American companies by foreigners. Foreign capital has assisted American economic development and growth since the country's birth. In response to the growing foreign challenge to American economic leadership and the sharp growth of Japanese direct investment here, various observers have questioned whether the United States should continue its laissez-faire attitude toward foreign purchases of technological assets.

According to the latest JEI study, Japanese acquisitions of American manufacturing companies in 1990 accounted for a greater portion of overall Japanese direct investment than ever before (see *JEI Report* No. 46A, December 13, 1991). Of 110 investments resulting in majority ownership in 1990, 65 were acquisitions of existing companies. This compares with 66 of 197 in 1988, and 74 of 189 in 1989. Some American observers fear that such takeovers allow the Japanese parent to transfer the technological assets of its new subsidiary back to Japan out of the public's sight and free of any interference from Washington. Anxiety over the consequences of foreign control is especially apparent when the subject of foreign investment has defense technology implications.

When confronting such anxieties it is helpful to inquire more deeply into the potential problems raised by foreign control. The main concern seems to be that a foreign-owned company is more likely to act against U.S. interests than a domestic company. This possibility could arise because of pressures applied by foreign governments, because of different values, or simply because of an insensitivity created by distance — the typical complaint against absentee owners. Policies to mitigate the potential problems of foreign control include diversification of technological linkages. This policy is often preferable to championing domestic contenders, which has the potential of creating permanent deficiencies. (See *JEI Report* No. 33A, August 28, 1992 for a look at related dependency concerns in the defense industry.) The issue concerning technology transfers and foreign investors has another side, however. While it is not clear whether such transfers are made back to the buyer's country, it is equally possible that the American subsidiary could be infused with technology from the parent firm or that the two could enter into joint research to the benefit of both. If backed by a parent with deep financial pockets and technology specialization of its own, the American subsidiary's research programs may be boosted rather than raided.

Some analysts have focused on Japanese funding of U.S. high-technology start-up companies, particularly in the electronics and biotechnology industries. It was feared that these new firms, desperate for capital, were making Faustian bargains with the Japanese, trading their technological jewels for money. The Japanese firms could buy access to some of America's most innovative companies for relatively little money. While there is anecdotal evidence that small U.S. electronics firms in the 1970s and early 1980s were failing to guard their intellectual property assets and not reserving enough geographic marketing rights for themselves, more recent reports indicate that American firms have begun to be much more careful about structuring their relations with foreign firms. The biotechnology industry had been a particular source of concern to those worried about technology transfer because Tokyo had made becoming a force in this new industry a national goal. Moreover, Japanese companies were eager to provide capital to American biotech start-ups. In this field, just as in the defense area, it appears that these fears were overblown.

The conditions attached to agreements whereby Japanese firms acquire American high technology companies or fund start-ups can alleviate many U.S. concerns. This lets each investment be judged on its individual merits. This approach recognizes the potential for American firms to benefit equally, if not more, from entering into a relationship with a Japanese firm. Plus, such a process encourages policymakers to clearly identify potential problems in advance so they can devise guidelines to ameliorate them.

Policy Options

At first glance it would appear that allowing foreigners to support U.S. research and development with both financial and human resources unquestionably would bolster America's technology base. When issues of control over the subject and the direction of research, ownership of commercially usable results and the true cost of foreign-sponsored research to the American economy are examined, discussion becomes far from simple. Not even the harshest critics of foreign-sponsored research favor protectionist measures that somehow would block foreign access, however; such moves might hinder the free interchange of ideas and research results that invigorates America's research system. Developing options that address the attractiveness of foreign sponsorship of U.S. research but clearly assign costs and balance benefits is an issue confronting companies, universities, and, possibly, government officials.

Japan - Japanese companies hardly can be faulted for tireless pursuit at home and abroad of new technology, the key to competitive advantage in an era of knowledge-intensive industry. Nevertheless, a debate has begun in Japan over the continued wisdom of the no-holds-barred attitude of domestic companies toward economic competition (see *JEI Report* No. 15A, April 17, 1992). Any such change in the psychology of corporate management most likely will be incremental, requiring more time than Japanese or American researchers feel they can afford before resolving these issues of concern. Several options have been broached for more direct, immediate Japanese action:

- More government-sponsored foreign research - Programs like the Human Frontiers Science Program and the Real-World Computing Project highlight both the potential and the pitfalls of this approach. Overcoming foreign suspicions about ulterior motives behind government sponsorship of foreign research is proving to be a major obstacle. But, just as it took time to build a reputation for being a technology absorber, it will take time before Tokyo's reputation will evoke a more balanced image. Once a mutual agreement is struck on the structure for foreign participation, the government-sponsored international cooperative research projects can become a showcase of Japan's commitment to contributing to global science and technology.

- Improve access for foreigners to Japan's research system - One way to blunt foreign criticism that Japan benefits unfairly from tapping into research resources abroad is to give foreigners greater opportunities to access its domestic research system. Tokyo already has opened its research consortia to foreign participation. The government also sponsors several programs designed to place foreign researchers in national laboratories. The Ministry of Education has ambitious plans to upgrade the quality and the quantity of research conducted in Japan's universities, a resource that will be freely available to foreigners. Since the high cost of living in Japan, language difficulties and other mundane problems reduce the attractiveness of Japan to foreign scientists, Tokyo is beginning to address these issues, too, providing housing and daily expense stipends as well as language training and other support programs.

Another possibility being eyed is for more Japanese companies to open their research laboratories to foreigners and to foster a more balanced flow of technology between Japan and its trading partners. Because corporate Japan funds the majority of R&D there (see *JEI Report* No. 28A, July 24, 1992), much of the leading-edge work is shielded from outside view by proprietary concerns. Nevertheless, some Japanese companies are beginning to realize that they can benefit from greater foreign input, including critiques of their research operations. Many companies have guest researcher programs specifically designed for foreigners and are working to link their global research facilities into a seamless network. Even with greater openness, the Japanese corporate R&D world is unlikely ever to be as open as the American university system, however.

United States - Washington consciously has been seeking to improve access to Japan's research resources to blunt criticism of an unbalanced bilateral technology flow. Opportunities for foreign researchers in Japan are far more numerous today, in fact, than even five years ago. In addition to the language and housing problems mentioned above, there is an element of elitism that is preventing some Americans and U.S. companies from taking advantage of the new opportunities. Policies to help break the "not-invented-here" syndrome that blinds American companies to foreign technology resources and to support U.S. scientists who want to do research in Japan are well within the reach of Washington. Just as it will take time for the Japanese to adjust their attitudes, so will it take time for some Americans to change theirs.

Dealing more directly with the issue of foreign-sponsored research in the United States, Washington has several options:

- Improve data collection - It is difficult to develop good policies without sound information. Although some companies are reluctant to discuss sources and extent of funding, public disclosure may have a sobering effect on the excesses of foreign firms bent on using their funding to gain extraordinary advantages. More information on foreign activities at federal research facilities can be tracked easily and would benefit policymakers. A reporting requirement similar to Section 1209 of the Higher Education Act could be made permanent for a variety of public research labs.

- Charge foreigners for access - To nullify the advantage available to foreigners that might join a project funded by prior U.S. investment in its research system, American laboratories could ask foreigners to pay more. Foreign students might be taxed or charged a much higher tuition, much as out-of-state students pay higher fees at state universities. Foreign firms could face higher fees for membership in university industrial liaison programs or even a "technology access" tax that could be plowed back into the American R&D machine. Foreigners hoping to tap into federal R&D resources could be asked to pay a higher fee.

- Restrict participation by foreigners - Washington could determine that some research topics are too sensitive for foreign participation. While this is established practice for areas related to national defense, there is some debate about widening the criteria to include national economic interests. The problem is how to define these interests and where to draw the line. Restricting foreign access to U.S. R&D may lead to a backlash against Americans overseas, losing the few hard-fought gains Washington has achieved. Restricting foreign access also may prevent Americans from learning from foreigners or from taking advantage of foreign research strengths.

- Issue guidelines for terms of contracts - If the content of foreign agreements with U.S. universities or companies is a concern, it is possible for Washington to assert regulatory authority over these commercial transactions. Fears that this would become a bureaucratic nightmare have some justification. Any benefits gained by preventing "bad" deals (and guidelines to make this evaluation would be both necessary and difficult to draw up) might be overwhelmed by losses stemming from approval delays or discouraged deals.

- Seek Japanese funding for U.S. research - If Washington is worried about foreign control of American research via the purse strings, it can set the research agenda then seek accompanying foreign funding. This is what Washington is doing with its Superconducting Supercollider project, a mammoth high-energy physics research facility. Beginning with the Reagan administration, the White House has been seeking foreign funding to help defray the cost. Tokyo is at the top of Washington's preferred donor list, but the Japanese have not yet agreed to commit money. Bilateral talks are continuing. Just as Tokyo ran into foreign suspicions of its international cooperative research initiatives, so has Washington encountered similar hesitation abroad regarding its grand research ideas.

Conclusion

The debate over the costs and the benefits of foreign-supported U.S. research is complex and subtle. Factors influencing the discussion include the relatively small foreign share of total American research outlays, the foreign portion's faster paced growth than the overall total, and the concentration of spending in certain areas. The number of foreign researchers in the United States also is small compared to the total number of scientists and engineers. Foreigners can comprise a significant portion of the staff at specific institutions, however.

The benefits of foreign support of R&D in the United States are significant factors in the debate. Foreign researchers, particularly those from Japan, are highly qualified and do excellent work. It is not certain that similarly trained Americans would be available if foreign researchers were barred from U.S. laboratories. Foreign researchers, with their different sociocultural backgrounds, also contribute to the vitality of U.S. science by providing a fresh viewpoint on issues and problems.

Japanese companies have a reputation for taking a long-term view of R&D and are willing to fund projects at home and abroad with payoffs well down the road. Fewer U.S.-originated projects may be funded if only American resources were available. Japanese firms that back U.S. research not only provide money but often contribute managerial skills to increase the productivity of research dollars. Foreign firms also can open a window to foreign technological developments, a window that Americans often ignore.

The legitimate questions that can be asked about foreign support for U.S. research, as it currently is structured, are many. Whether foreigners are paying a fair price for access to U.S. science and technology resources is one valid issue. Moreover, a long-standing American political-economic tenet asserts that agreements between knowledgeable consenting adults provide mutual benefits to the contracting parties. Price distortions from subsidies or a national interest that deviates from private interests could make some private transactions undesirable in a broader evaluation, however. In addition, a lack of information makes it unclear if an accurate and fair price can be determined. Whether research agreements with foreigners yield an acceptable balance of benefits to both sides is part of the debate. And whether the federal government should take action to regulate the content of these pacts is equally fair game for discussion. Officials' most productive activity might be to focus on policies that improve the quantity, quality and interchange of research not only in the United States but globally. As with trade in goods, more trade in ideas is preferable to protectionism from a theoretical standpoint.

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Notes

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[2] National Science Board, *Science and Engineering Indicators, 1991* (Washington, D.C.: U.S. Government Printing Office, 1991), pp. 260-261.

[3] U.S. General Accounting Office, *Technology Transfer; U.S. and Foreign Participation in R&D at Federal Laboratories*, (Washington, D.C.: U.S. General Accounting Office, 1988), pp. 16-23.

[4] "International Group to Build Combined-Cycle Hypersonic Engine," *Aviation Week & Space Technology*, August 17, 1992, p. 50.

[5] Nippon Boeki Shinkokai Kaigai Keizai Joho Senta (Japan External Trade Relations Organization, Overseas Economic Information Center), *Zai Bei Nikkei Seizogyo Keiei no Jittai — 1991 Nen Chosa (Dai Juichi Kai) (The State of Japanese Manufacturing Subsidiaries in the United States — 1991 Survey [11th Edition])* (Tokyo: Government of Japan, 1992), pp. 52-54.

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[7] Joseph Weber *et. al.*, "Pure Research, Compliments of Japan," *Business Week*, July 13, 1992, pp. 136-137.

[8] Genther, *op. cit.*, p. 5.

[9] U.S. General Accounting Office, *R&D Funding; Foreign Sponsorship of U.S. University Research,* (Washington, D.C.: U.S. General Accounting Office, 1988), p. 8.

[10] *Ibid.,* p. 18.

[11] Stephanie Epstein, *Buying the American Mind; Japan's Quest for U.S. Ideas in Science, Economic Policy and The Schools,* (Washington, D.C.: The Center for Public Integrity, 1991), pp. 4+.

[12] *Ibid.,* pp. 13-14.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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J A P A N · E C O N O M I C · I N S T I T U T E

JEI REPORT

A Two-Part Report: A and B

NO. 36B
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Yen Sits On The Sidelines During Currency Brouhaha

The yen appears to have a new, if familiar partner, in international currency markets: the dollar. In the week of September 13-19, during which the European Exchange Rate Mechanism became unglued, the values of the yen and the dollar vis-a-vis each other were virtually unchanged, continuing a pattern that has persisted for more than two months. An intergalactic traveler could have been forgiven for assuming that the linkages of currencies discussed so much that week must have featured the dollar and the yen rather than such European currencies as the pound sterling and the Deutsche mark.

Yen-dollar stability continued in mid-September in a pattern shaped over the summer. During July and August, for example, the yen varied between ¥123.4=$1.00 to ¥128.2=$1.00, a smaller percentage variation than the pound exhibited against the Deutsche mark in the week in which London suspended participation in the ERM. Ironically, the yen was free to float against the dollar during that time while, in principle, the pound-to-Deutsche mark relative value was supposed to be virtually fixed.

Of course, since the 1990 addition of the pound to the linkage between the Deutsche mark and most other European currencies in ERM, the variation in the value among the European currencies nationwide network of manufacturing centers. The Bush administration, meanwhile, has threatened to veto the bill. While the amendment proposed by Rep. Walker incorporates several aspects of the economic recovery plan outlined by Mr. Bush early this year, many Republicans see in HR 5231, as drafted by Democratic lawmakers, a misdirected attempt to move federal government toward an assertive industrial policy.

On September 8 Gov. Clinton presented a manufacturing strategy that addresses some of his earlier competitiveness proposals as well as aspects of the U.S. Economic Leadership Strategy unveiled by Senate Democrats this July (see *JEI Report* No. 27B, July 17, 1992). The Democratic candidate's proposal provides a blueprint for shifting current research and development funds from defense to civilian uses. One element of this plan is to establish 170 new technology centers intended, in part, to facilitate the process of defense conversion. The manufacturing strategy also reiterates Gov. Clinton's intention to make permanent the R&D tax credit and to provide an investment tax credit. He also calls for further government support for research into new products and for export promotion.

After further consideration September 22 and 23 the House passed by a 287-122 vote the National Competitiveness Act. Yet at this late point in the congressional calendar the prospects for the bill becoming law are uncertain, even though the Senate passed a companion measure in late June. Moreover, partisan disagreement over the best way to help American companies compete internationally may continue to hamper HR 5231's progress. Given the concerns about U.S. competitiveness in both political camps, various solutions are certain to be discussed both during and after the presidential election campaign.

Margo Grimm

Economic Downturn May Highlight Attitudes Toward Japanese Working Women

The dichotomy between the current surplus of workers because of the economic downturn and the long-term shortage of labor, as implied by projected labor force statistics for 1995 and beyond, may put women and those who hire them in a quandary. Even though Japan's 1985 Equal Employment Opportunity Law says employers may not treat women differently from men in retirement or dismissal, news reports about how companies are handling the economic downturn through changes in staffing point to a disproportionate impact on women. Some reports, from the Japan Securities Dealers Association, for example, have hinted at layoffs predominantly of female employees. Other reports have described the job-hunting difficulties faced by young women planning to graduate next spring, who had hoped to pin down a job offer in the summer recruitment season. Last year, in fact, more men than women were hired for the first time since 1986. The male population in the prime years of hiring eligibility (ages 20-24) is 3 percent larger than the female population (and men outnumber women in all age groups until the 45-49 age group), but the edge in hiring new employees of all ages was 8.6 percent in favor of men last year.

Further complicating attitudes about women working is the government's concern about Japan's shrinking fertility rate, now at a low 1.53 children that a Japanese woman currently of child-bearing age would be expected to bear in her lifetime. A fertility rate much below 2.0, with little in-migration of laborers, translates to future labor shortages — and the associated concerns about employee contributions to social security and national health insurance in a society where those over age 65 will make up more than one-fourth the population by the year 2020.

Before the Japanese economy began to feel the effects of a slowdown amid rising inventories and falling investment, the government had encouraged enterprises to address the prospective labor shortage by hiring more women and retaining older employees. The government also, of course, hoped some women would stay home and have children, since a certain number of children are necessary as future workers who can contribute to the support of their parents and others of the older generation.

Of interest to those observers of working women in Japan is whether the current economic downturn will lead to an upswing in the birth rate. A study in the late 1970s by economists William Butz and Michael Ward for Rand Corp. indicated that when American women's pay dropped below the "opportunity costs" of staying home and having children then, indeed, fertility rates could be expected to increase. Writing in the 1979 *American Economic Review,* the authors noted that at business cycle peaks women's wages tend to rise, which increases the incentives for women to stay on the job rather than dropping out of the workforce, even temporarily, to have children. Conversely, the poor job prospects of a recessionary economy provides the incentives for women to consider having children, particularly if they expect family income to be depressed only temporarily.

Since this model points to the possibility of higher fertility rates in times of recessions and suggests that a change in women's income levels is one of the components that influence a typical couple's decision on whether or not to have children at a particular time, some analysts have suggested that Japan's fertility rate, indeed, may climb in next year's statistics. Japan's population actually increased in 1991 by 0.35 percent, with the number of births rising by 11,318 over those recorded in fiscal 1990, the first upswing since the Ministry of Home Affairs began following the statistics in 1979. But the fertility rate decreased, as it has been doing since 1984.

Among the factors cited in Japan for the declining fertility rate are: a delay in the ages at which couples marry and decide to ~~have~~ children; a growing interest among increasingly well-educated Japanese women to continue working after marriage or perhaps not marry; and economic necessity to meet the high costs of rearing children in a country where houses are small and top-of-the-line education costly but essential for future success. Some analysts also have pointed to possible dual disinclinations: of commuting husbands, who spend little time at home and feel overworked, and of overburdened wives, who may feel trapped by the rigors of perhaps a parttime job plus household and child care or care of parents without help from a husband.

The current economic downturn could alter these factors in several ways. In that companies are slashing overtime hours because of recession-motivated attention to costs, some commuting husbands might spend more time at home. This result in itself could have both positive and negative effects on the fertility rate, depending on whether the husband contributes to housework and child care or is considered a "wet autumn leaf" that sticks to his wife, adding to her duties in the home. (See *JEI Report* No. 25A, July 3, 1992 for details regarding Japanese men's work and leisure activities.) Another recession abatement effort suggests a likely damper on the prospects for an upswing in the fertility rate, however. In this case, companies' actions to shift workers either to other firms that need staff or to another location within the same company could increase the commute for spouses, particularly if these positions are in another city. In the latter case home visits could be for the weekend instead of nightly. Most of these transfers affect men, since few women are in the employment track that encompasses job transfers and promotions toward upper-level management. Regardless, the impact of the transfers on the fertility rate most likely would be negative.

If the findings of Messrs. Butz and Ward characterize conditions in Japan today, some of the other steps being taken to trim labor costs could have a silver lining in the eyes of a government hoping to reverse the downward movement of Japan's fertility rate. Conventional wisdom suggests that couples would react to corporate Japan's plans to hire fewer people, cut bonuses and slash wages among managers (all of which erode income security) by not rushing to increase family size. If these actions are seen as temporary inconveniences, however, many couples might decide that the current downturn is a good time for the wife to spend more time at home, bearing and raising children.

The economic downturn comes at a particularly critical time for assessing the various impacts from the 1985 Equal Employment Opportunity Law and whether the law has promoted change. Since 1985 there has been an increase in the number of women attending college, for example. In 1990 women made up 30 percent of new university enrollees, while they numbered only 25.3 percent in 1985 and slightly less than 23 percent in 1979. Those who entered the job market when the law went into effect also are now at a prime age to begin having children. Japanese women increasingly have delayed marriage, with the average bride being 25.9 years old in 1990 as compared to 25.2 in 1980 or 24.2 in 1970. Along with this delay has come a shift toward more women bearing children at a later age. In 1970 nearly half of all mothers were in the 25-29 age bracket with 26.5 percent aged 20 to 24

Relationship Between State of Economy, Women Working, Fertility Rate

Business Cycles by Month, Year	State of Economy	Year	Women Workers as Percent of All Workers	Female Workers as Percent of Women, aged 15+	Specific Birth Rate (Fertility Rate)
6/1958 to 12/1961	Expansion	1960	40.7	54.6	2.00
		1961	40.6	54.3	1.96
12/1961 to 10/1962	**Recession**	**1962**	**40.3**	**53.4**	**1.98**
10/1962 to 10/1964	Expansion	1963	40.0	52.0	2.00
		1964	39.9	51.1	2.05
10/1964 to 10/1965	**Recession**	**1965**	**39.7**	**50.6**	**2.14**
10/1965 to 7/1970	Expansion	1966*	40.0	50.9	1.58
		1967	40.0	51.2	2.23
		1968	39.6	50.7	2.13
		1969	39.4	50.1	2.13
		1970	39.3	49.9	2.13
7/1970 to 12/1971	**Recession**	**1971**	**38.7**	**48.8**	**2.16**
12/1971 to 11/1973	Expansion	1972	38.1	47.8	2.14
		1973	38.4	48.2	2.14
11/1973 to 3/1975	**Recession**	**1974**	**37.6**	**46.5**	**2.05**
3/1975 to 1/1977	Expansion	1975	37.4	45.7	1.91
		1976	37.4	45.8	1.85
1/1977 to 10/1977	**Recession**	**1977**	**38.0**	**46.6**	**1.80**
10/1977 to 2/1980	Expansion	1978	38.4	47.4	1.79
		1979	38.6	47.6	1.77
2/1980 to 2/1983	**Recession**	**1980**	**38.7**	**47.6**	**1.75**
		1981	**38.7**	**47.7**	**1.74**
		1982	**39.0**	**48.1**	**1.77**
2/1983 to 6/1985	Expansion	1983	39.5	49.0	1.80
		1984	39.6	48.9	1.81
		1985	39.7	48.7	1.76
6/1985 to 11/1986**	**Recession**	**1986**	**39.8**	**48.6**	**n.a.**
11/1986** to -- ***	Expansion	1987	39.9	48.6	1.69
		1988	40.1	48.9	1.66
		1989	40.4	49.5	1.57
		1990	40.6	50.1	1.54
		1991	40.7	50.6	1.53

*The year 1966 coincides with the 60-year cycle superstitiously referred to as "hinoeuma," or "c-horse;" females born in that year are said to have an ominous fate. Many women prefer not to risk imposing that fate on daughters and, thus, try to avoid giving birth that year.

**Unofficial

***The Economic Planning Agency has not determined when the latest expansion ended.

Sources: Economic Planning Agency, Ministry of Labor and Ministry of Health and Welfare and 18.5 percent aged 30 to 34; by 1990 the percentage of younger mothers had dropped to 15.7 percent while the group of mothers aged 25 to 29 had shifted to 45.1 percent and those aged 30 to 34 had increased to 29.1 percent.

Women aiming at a career and who came into the workforce soon after the EEO law took effect might have been expected to resist layoffs because of their protection under the 1985 law, but they are now of an age where they might want to take time off to bear children. Given the tough economic times, companies are unlikely to encourage these women to stay on the job, particularly if they were hired into what some analysts have described as a corporate reaction to the equal employment law: a two-track system. This system involves one career track focused on promotion opportunities that require potential job transfers and the other is considered a lower-level, noncareer track that serves primarily women. News reports have indicated that young women trying to enter the job market this year were being encouraged to take jobs with lower salaries and less challenge. Such jobs are easier to leave, if a woman decides to become pregnant, a situation that coincides with the findings of Messrs. Butz and Ward.

These findings are not readily supported by simple labor force participation rates for Japanese women and the downward trend in fertility rates, which do not appear to have a strong connection to past recessions in Japan (see Table). Application of the Butz-Ward model to Japan in the current downturn is made more difficult because of the increasing numbers of educated women in Japan, the adoption of the equal employment opportunity law and its potential changes, and past trends among Japanese women. These trends show a surge in employment among young women who work for a few years after whatever level of schooling they achieve then drop out of the workforce, either after marrying or — more frequently — after becoming pregnant. The strong tendency of Japanese women to reenter the workforce in parttime jobs also could impact this model, since adjustments to parttime hours are another way in which companies can deal with recessions. Future changes in the fertility rate obviously will be subject to a plethora of variables.

Pat Murdo

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The views expressed in this report are those of the authors and do not necessarily represent those of the Japan Economic Institute.

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JEI

REPORT

A Two-Part Report: A and B

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Japan's GNP Grew Sluggishly In Second Quarter

Based on gross national product statistics released September 22 the Japanese economy would appear to be suffering a mild ailment at worst. On a price-adjusted annual basis GNP grew in the April-June quarter at a less than robust 1.1 percent. Although by some yardsticks that was an adequate rate of expansion, a closer look reveals that, absent the economic equivalent of artificial respiration, the economy in the spring would have suffered one of the sharpest declines in Japan's postwar history.

The key to understanding the slowdown in Japanese growth is to divide the economy into three components: domestic private sector, foreign trade and government. In the second quarter private domestic demand, consisting primarily of consumer spending plus plant and equipment investment, fell 2.8 percent on an annualized basis. This drop was the sharpest since the fourth quarter of 1974, in the midst of the first oil crisis. A 10.3 percent annualized jump in housing construction broke a string of six straight quarterly declines but carried far too little weight to counterbalance lower consumer and capital spending. Had the rest of the economy treaded water, the value of goods and services would have contracted 2.4 percent annualized, simply from the falloff in private domestic spending.

The decline in private domestic spending suggests that the economy had trouble breathing on its own during the spring. Succor came from growth in the foreign and government sectors.

Japan's Real Gross National Product at Constant (1985) Prices

(in billions of yen, seasonally adjusted, quarterly totals and rates of growth at annual rates)

	FY 1990	FY 1991	July-September 1991	October-December 1991	January-March 1992	April-June 1992
Gross Domestic Product	¥406,615.1 (5.7%)	¥420,682.1 (3.5%)	¥420,211.8 (1.7%)	¥420,104.1 (-0.1%)	¥423,807.5 (3.6%)	¥424,568.5 (0.7%)
Gross National Product	409,214.5 (5.5%)	423,591.3 (3.5%)	423,052.8 (2.0%)	422,715.7 (-0.3%)	427,321.2 (4.4%)	428,444.6 (1.1%)
Personal Consumption Spending	234,085.0 (4.0%)	240,669.0 (2.8%)	240,449.8 (3.0%)	240,692.7 (0.4%)	242,895.8 (3.7%)	242,834.4 (-0.1%)
Private Residential Construction	22,848.6 (4.9%)	20,260.8 (-11.3%)	20,620.8 (-9.0%)	19,621.3 (-18.0%)	19,601.8 (-0.4%)	20,086.1 (10.3%)
Private Fixed Nonresidential Investment	88,990.7 (12.1%)	91,642.9 (3.0%)	92,225.3 (2.9%)	91,491.3 (-3.1%)	91,284.0 (-0.9%)	89,062.9 (-9.4%)
Change in Business Inventories	2,901.4 (-20.8%)	3,225.9 (11.2%)	3,420.9 (35.2%)	3,075.5 (-34.7%)	3,263.1 (26.7%)	2,595.1 (-60.0%)
Government Current Expenditures	34,428.7 (2.4%)	35,428.9 (2.9%)	35,114.8 (-5.3%)	35,297.1 (2.1%)	35,700.0 (4.6%)	35,718.0 (0.2%)
Government Fixed Investment	26,095.1 (4.4%)	27,572.8 (5.7%)	27,392.6 (0.2%)	27,655.8 (3.9%)	27,798.3 (2.1%)	29,830.3 (32.6%)
Change in Government Inventories	95.1 (*)	-197.4 (*)	240.8 (*)	-942.6 (*)	91.8 (*)	317.1 (*)
Net External Sector	-230.1 (*)	4,988.4 (*)	3,587.8 (*)	5,824.6 (*)	6,686.4 (*)	8,000.7 (*)
Exports of Goods and Services and Factor Income Received	73,760.4 (7.7%)	77,217.8 (4.7%)	76,671.6 (10.4%)	77,949.8 (6.8%)	79,389.6 (7.6%)	77,042.1 (-11.3%)
Imports of Goods and Services and Factor Income Paid	73,990.6 (7.2%)	72,229.4 (-2.4%)	73,083.8 (11.9%)	72,125.2 (-5.1%)	72,703.2 (3.2%)	69,041.4 (-18.7%)

*Cannot be calculated or meaningless.

Source: Economic Planning Agency

Although these two sectors together constitute a mere 17.2 percent of Japan's economy, they made up the April-June shortfall in private domestic spending and then some. Public investment, for example, was up a whopping 32.6 percent on an annualized basis. This jump reflected the government's April decision to accelerate public works expenditures by spending around 75 percent of the 1992 fiscal year budget in the April-September period (see *JEI Report* No. 14B, April 10, 1992). By itself this increase would have been sufficient to raise real GNP 2 percent, other factors equal.

Foreign trade was the other positive element in GNP, although in a very incidental way. Price-adjusted exports dropped 11.3 percent in the April-June period, indicating that Japanese companies were unable to export their way out of domestic difficulties. Imports dropped 18.7 percent, more than offsetting the effect of lower exports and lifting GNP significantly. Of course, the falloff in imports merely reflected the weakness of demand generally and cannot be interpreted as a sign of strength in the economy.

The inclusion of an extra day for leap year in the January-March period raised the base against which growth rates were calculated for the second quarter. The rate of change in consumer spending was depressed partly in the April-June period for this reason. However, the 1.8 percent annualized growth of consumer spending during the first and second quarters — a figure that largely eliminates the leap year effect — suggests that personal consumption, supposedly one of the strongest parts of the Japanese economy, was growing very slowly in this year's first half. Recent data indicate that consumer sentiment has continued to weaken, implying that policymakers cannot count on consumers to bail out the economy.

Nor will plant and equipment spending come to the rescue. Japanese policymakers sometimes assume that business investment will revive in response to lower interest rates, even though capital spending has dropped since last October — a period during which interest rates declined. Despite its weakness, private capital spending remained a high 20.8 percent of real GNP in the April-June quarter, several percentage points above its historical average. The best that can be expected is that plant and equipment spending will not go into a free-fall in response to weak domestic and foreign economic conditions.

Conversely, government investment will remain strong, at least for the time being. GNP data for the July-September period, to be released in late December, will continue to reflect the program to accelerate public works. Assuming that the government's large economic stimulus package passes the Diet in a timely fashion this fall (see *JEI Report* No. 36B, September 25, 1992), public works spending will remain robust through the second half of fiscal 1992, which ends March 31. Should the package face significant delay, however, public works spending might make a relatively small contribution to net growth after September.

The foreign trade situation is harder to read. If overseas markets revive, exports may pick up. The yen's recent strength, largely unanticipated, could sharply limit or eliminate profits from foreign sales if it continues at its late September level of ¥120 to the dollar or stronger. Press accounts already suggest that manufacturers are scaling back export plans. Given that overall profits are falling (see following article), Japanese companies may be disinclined to chance further losses in risky foreign markets. In their perverse fashion imports may contribute to economic growth by dropping again, a phenomenon that will bring no joy to trade officials in Tokyo. Analysts worry about both the weakness of domestic demand as implied by anemic imports and about the likelihood of renewed criticism from trading partners skeptical about the openness of Japanese markets.

In short, the outlook for the Japanese economy during the balance of calendar 1992 is for more of the same pattern displayed in the second quarter. Economic expansion by means of government life support technically may lead to reports of reasonable overall growth figures, but the underlying weakness of the economy will remain.

Douglas Ostrom

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JEI

REPORT

A Two-Part Report: A and B

NO. 38A

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THE SAGAWA AFFAIR AND IMPLICATIONS FOR A POLITICAL SHAKE-UP

SUMMARY

Barely three years after the Recruit Co., Ltd. influence-peddling affair drew to a close Japan's ruling Liberal Democratic Party again is mired in a scandal concerning alleged illegal payments to prominent party members. The late August admission by LDP kingpin Shin Kanemaru that he had received millions of yen in unreported political contributions from Tokyo Sagawa Kyubin Co., Ltd. has potential systemwide impact as well as disruptive possibilities for the ruling party itself.

Analysts disagree as to whether the Sagawa affair will become the proverbial last straw that prompts an increasingly disaffected electorate to turn away from the LDP. Concerns for such a development could persuade the LDP to promote the broad reforms that many say are needed to transform Japan's money-centered political system. Success in this attempt is problematic. Mr. Kanemaru's resignation as LDP vice president in the wake of the Sagawa revelations could distract the ruling party by precipitating a shake-up from which a new party structure and group of leaders would emerge.

Changes in the LDP loom large, partly as a result of the Kanemaru affair but also because of a push for generational change. Upheaval within the LDP also appears imminent, if not because of personalities and scandals, then possibly because of the new business and political relationships that have developed as the economy has changed. LDP reorganization would have implications for the way the ruling party conducts its internal affairs as well as develops domestic and foreign economic and political initiatives.

Scandal Dethrones the Kingpin

The arrest in February this year of Hiroyasu Watanabe, then president of Tokyo Sagawa Kyubin Co., Ltd., and other top company officials for making fraudulent loans to firms allegedly affiliated with the Inagawa-kai crime syndicate became front-page news in Japan. What made this event even more newsworthy than other cases involving business ties to the underworld were reports that extraordinary sums of money — initial estimates ranged from ¥540 billion ($4.3 billion at ¥125 = $1.00) to ¥11 trillion ($88 billion) — had been kicked back from these loans and lavished on more than 100 politicians in the ruling Liberal Democratic Party as well as the opposition parties (see *JEI Report* No. 7B, February 21, 1992).

Coming only three years after the Recruit Co., Ltd. influence-peddling affair — a scandal that implicated several senior LDP officials and contributed to the ruling party's unprecedented loss of control of the Diet upper house in July 1989 elections, ruling party politicians earlier this year probably had a feeling of deja vu. When the late July upper house contests resulted this year in a solid win for the LDP, these concerns appeared allayed for the time being (see *JEI Report* No. 29B, July 31, 1992). Nevertheless, ruling party politicians remained on tenterhooks as the Tokyo Prosecutor's Office investigated to uncover recipients of the Sagawa money. The prosecutor's office evidently leaked to the media in early August that Mr. Watanabe had told them that he had distributed about ¥2.1 billion ($16.8 million) to 11 LDP Diet members, including former prime ministers, and one former opposition party head.

By late summer it had become apparent that the prosecutors were out to net the biggest fish of all, Shin Kanemaru, considered by many to be the most powerful politician in Japan today. After the July upper house elections media reports began surfacing that Mr. Kanemaru had received money from Mr. Watanabe as far back as 1989, just prior to the July upper house elections that year, when the Recruit affair still made newspaper headlines. At a late August news conference the LDP doyen clarified that he had accepted ¥500 million ($4 million) in unreported "campaign contributions" from Mr. Watanabe before the February 1990 lower house elections but not before the previous summer's elections. In a move that stunned the ruling party Mr. Kanemaru resigned his posts as LDP vice president and head of the largest LDP faction, named for former Prime Minister Noboru Takeshita.

Mr. Kanemaru insisted, however, that he originally refused to accept the money, described in news reports as delivered to one of Mr. Kanemaru's secretaries in a grocery cart full of 50,000 separate ¥10,000 ($80) bills. Investigators believe that the money from the former Tokyo Sagawa chief, in turn, was disbursed to about 60 Takeshita faction members engaged in tough campaigns for the lower house. In a well-timed apology one day before the government was to dominate headlines with its announcement of a long-awaited fiscal stimulus package the LDP kingpin expressed his deep regret for exceeding the limits of the Political Fund Control Law. That law limits an elected official from receiving more than ¥1.5 million ($12,000) in campaign contributions from a single source within one year's time (see *JEI Report* No. 34B, September 4, 1992).

Mr. Kanemaru subsequently agreed to a plea bargain with the Tokyo Prosecutor's Office in a move that some analysts contend was aimed at short-circuiting any information presented during Mr. Watanabe's trial that might contradict the LDP doyen's account of his relationship with the former delivery company executive. Mr. Watanabe's trial began in late September. In exchange for a signed statement in which Mr. Kanemaru admitted violating the Political Fund Control Law prosecutors issued a summary indictment — used only in the case of "light crimes" — and fined Mr. Kanemaru ¥200,000 ($1,600). A summary indictment does not require the accused to appear in court, thereby allowing Mr. Kanemaru to avoid answering questions about his alleged use of Mr. Watanabe as an intermediary in dealing with certain organized crime figures, a more serious accusation (see *JEI Report* No. 38B, October 9, 1992).

Prosecutors evidently could not charge Mr. Kanemaru under Japan's antibribery statute since this law applies only to politicians who have government posts with direct authority over the bribing

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parties when the money is given. Mr. Kanemaru was not in such a post in early 1990. Moreover, the senior LDP member's apparent distribution of the cash to other Takeshita faction members rather than pocketing the entire amount for himself makes it harder to mount an effective bribery case against him, some analysts say.

The LDP doyen is only the second Diet member ever to be charged under the Political Fund Control Law. The late Prime Minister Eisaku Sato was indicted in 1954 for violating this law when he was serving as LDP Secretary General. The case against Mr. Sato subsequently was dropped as part of the general amnesty proclaimed to celebrate Japan's admission to the United Nations.

The summary indictment against Mr. Kanemaru drew contempt from some members of the political opposition and citizens' groups. They viewed it as a mere wrist slap given the enormous sum of illegal contributions accepted by the LDP kingpin. The political opposition responded to the punishment by calling for Mr. Kanemaru's resignation from the Diet and his acceptance of moral responsibility for the affair. The LDP is expected to resist strongly such demands. Nevertheless, Mr. Kanemaru's apparent "dethronement" will have a destabilizing impact on the political scene in the following areas:

Diet Paralysis - Although Mr. Kanemaru's plea-bargain arrangement ensures that he will not appear in court, the opposition parties have demanded that the former LDP vice president as well as the other 11 alleged recipients of Sagawa money — if they are made known during the course of Mr. Watanabe's trial — be summoned to the Diet to testify. In particular, some members of the political opposition want to probe further into Mr. Kanemaru's alleged use of the former Tokyo Sagawa president in September 1987 as a go-between with Susumu Ishii, the late leader of the Inagawa-kai. The meeting reportedly was set up to secure the mob's help in silencing a right-wing group that was harassing Mr. Takeshita as he campaigned for LDP president.

Tying up Diet debates with Sagawa-related testimony would impede the LDP-led government's efforts to use the extraordinary Diet session, set to begin October 30, to enact the stimulative supplementary budget announced in late August (see *JEI Report* No. 34B, September 4, 1992) and pass political reform legislation. If the LDP and opposition parties lock horns over the Sagawa issue, the legislative clock could run out without Diet action on any matter. In this regard the opposition parties risk making themselves, rather than the LDP, look bad if their stance on the Sagawa affair impedes passage of a budget that contains a variety of economic measures supported by the public. In an apparent effort to avoid Diet paralysis unidentified sources in Prime Minister Kiichi Miyazawa's office reportedly have suggested that limited Diet discussion of alleged ties between politicians and the mob might be possible.

LDP Image Problem - The admission of wrongdoing by a politician of Mr. Kanemaru's stature and his subsequent indictment still may create problems for the LDP when voters go to the polls next year, probably in July, to select their representatives for the House of Representatives. The lower house, which has the final say on money bills and treaties and in appointing the prime minister, is considered more powerful than the House of Councillors. Thus, if the LDP wants to continue to govern the country without having to enter into a coalition with one or more opposition parties, it cannot incur significant losses in the lower house races.

Memories of the ruling party's unprecedented losses in the July 1989 upper house elections still are fresh in the minds of LDP politicians. Three issues angered voters in these elections: the Recruit affair, which involved questionable political contributions and, in some cases, outright bribery; implementation of a 3 percent consumption tax; and the scheduled opening of Japan's beef and orange markets. Not likely to forget that the public's sense of what is just and fair had been offended are several senior LDP officials, including former Prime Minister Takeshita and Mr. Miyazawa, who had been finance minister through 1988; both were forced to resign to accept responsibility for what was perceived at the grass roots as unethical conduct.

Not only has the Sagawa scandal broken barely three years after the Recruit affair, but Mr. Kanemaru's indictment comes only eight months after a former close associate of Mr. Miyazawa was arrested on bribery charges (see *JEI Report* No. 4B, January 31, 1992). The former LDP vice president's acceptance of Mr. Watanabe's fortune-distorting "campaign contribution" has reminded voters that money, as described by many political watchers, has become the lubricant of Japanese politics.

Political experts have mixed views as to whether the public will lash out at the ruling party in next year's lower house contests to protest the involvement with Tokyo Sagawa Kyubin of Mr. Kanemaru and, according to rumors, other high-ranking LDP members. Although electoral behavior since the 1989 upper house elections appears to indicate that the Japanese people have become increasingly disenchanted with the LDP, voters have refrained from seriously threatening the ruling party's leadership. One often-cited reason for the status quo is the failure of the opposition parties to offer a credible alternative government (see *JEI Report* No. 31A, August 14, 1992).

Some analysts contend that the Japanese public for the most part is aware that the Sagawa affair is not a specific incident of corruption so much as it is characteristic of a systemic problem that they, as voters, feel powerless to change. Robert M. Orr Jr. of Temple University Japan compares the Japanese public's reaction to both the Sagawa scandal and Mr. Kanemaru's indictment to the American public's impatience and boredom with early stages of the Watergate scandal. "Shikata ga nai [it can't be helped]" has been a typical interview-on-the-street reaction to Mr. Kanemaru's behavior, Mr. Orr says.[1] Despite the protests staged by citizens groups and opposition party members outside the courthouse after Mr. Kanemaru's indictment and the angry editorials that appeared in some newspapers, the disenchantment at this stage is insufficient, Mr. Orr and others say, for the ruling party to lose the helm over the Sagawa affair.

What differentiates the Sagawa scandal from the Recruit affair and other incidents of corruption in recent years, however, is the involvement of organized crime groups, known as *yakuza*. Underworld ties to political figures have become an open secret in Japan. Perhaps the best-known case is the bribery scandal in the early 1970s involving Lockheed Corp.'s attempt to win All Nippon Airways Co., Ltd.'s business. According to those familiar with such cases, *yakuza* members often are employed by politicians as fund-raisers, bodyguards and campaign workers (see *JEI Report* No. 18A, May 8, 1992).

To the Japanese public, however, elected officials' ties with mobsters are seamy and distasteful. If, during the course of Mr. Watanabe's trial, Mr. Kanemaru specifically is named as the politician who requested *yakuza* intervention in a right-wing group's efforts to disrupt Mr. Takeshita's campaign, or if evidence emerges as a result of an opposition party-driven Diet inquest that the 11 other politicians who are rumored to have received money from Mr. Watanabe also dealt with Mr. Ishii or other crime bosses, Japanese voters might be less willing to ignore this information. The LDP, as a result, could be hurt in next year's lower house contests or in by-elections that may occur in the coming year. Perhaps it is for this reason that Mr. Miyazawa has hinted that he would entertain during the upcoming special Diet session discussion of, or introduction of, legislative proposals that specifically address politicians' relations with underworld groups.

In further attempts at damage control LDP officials have indicated that they would push for early passage of stopgap electoral reforms during the extraordinary session. This legislation would narrow the discrepancy in vote values for less populous and populous areas to about 2 to 1 (see *JEI Report* No. 34B, September 4, 1992). Mr. Miyazawa also indicated that he would urge quick completion of more sweeping reforms of Japan's multiseat system that, among other changes, would replace the present scheme of multiseat districts with a single-seat system. Many analysts have attributed the recurrence of political scandal in Japan to the multiseat system, which demands that politicians raise vast sums of money in order to win a seat (see *JEI Report* No. 10A, March 10, 1989).

The prime minister's attempts to prove to the public that the ruling party is sincere in its stated desire to reform itself probably will encounter strong resistance from the opposition parties and possibly from within the LDP, since some politicians are bound to lose their seats with the dismantling of the current system. Add to this the political opposition's desire to exacerbate the ruling party's image problems by tying up the Diet with debate over the Sagawa affair, and the outlook for political reform is not good. In view of the Japanese public's apparent indifference to the business of Japanese politics, it is doubtful that, in and of itself, the LDP's failure to enact sweeping electoral reforms would hurt the ruling party. However, inaction on political reform, combined with more serious revelations with regard to the Sagawa affair, might be the catalyst for an anti-LDP revolt at the polls. Much depends on whether the opposition parties can force senior LDP members and, possibly, Mr. Watanabe to testify before the Diet and whether they can eke out damaging information from what surely would be a group of unwilling witnesses.

Leadership Vacuum - Perhaps most significant for the ruling party is that Mr. Kanemaru's resignation as LDP vice president and uncertain status as head of the Takeshita faction create a vacuum that could precipitate a splintering of the factions and jockeying among members for new leadership. Ironically, the senior LDP member evidently did not harbor ambitions of becoming prime minister — perhaps because he wielded far more influence from behind-the-scenes. Over the years he variously has been referred to as the ruling party's mentor, financeer, kingmaker and the "glue" that holds together the LDP's traditional, seniority-based factional system.

Mr. Kanemaru also came to be regarded as an elder statesman, of sorts. This was due, in part, to his coleadership with Makoto Tanabe, then vice chairman of the Social Democratic Party of Japan, of a diplomatic mission to North Korea in the fall of 1990. The trip not only led to the release of two Japanese seamen who had been held since 1983 but gave the first inkling of better relations on the horizon with Pyongyang (see *JEI Report* No. 38B, October 5, 1990). "Bridge-builder" is another word that has been used to describe Mr. Kanemaru's political skill. For many years he has enjoyed close relations with members of the politicial opposition, particularly Mr. Tanabe, who now is SDPJ chairman. These contacts have proved invaluable in maintaining a dialogue with the opposition parties on any number of different issues and, in certain cases, fashioning compromises in order to secure Diet enactment of LDP-proposed legislation.

Some commentators contend that were it not for the very high esteem with which Mr. Kanemaru has been held in political and government circles, the former LDP vice president's lawyer would not have been successful in cutting a deal with the Tokyo Prosecutor's Office allowing Mr. Kanemaru to get off with a relatively lenient sentence.[2] There also is a view that, in deference to the powerful Mr. Kanemaru, prosecutors deliberately waited until after the late July upper house elections to break the story of Mr. Watanabe's dealings with the ruling party kingpin.

Underscoring the prestige that Mr. Kanemaru enjoys were reports that Mr. Miyazawa sent Motoji Kondo, deputy chief cabinet secretary, to the LDP doyen's home immediately after he announced his resignation to urge the senior politician to stay in this post. It is common knowledge in Japanese political circles that Mr. Miyazawa owes his election last October to the LDP presidency and, thus, to the prime minister's post to Mr. Kanemaru. The prime minister needed the endorsement of the large Takeshita faction (see Table) to clinch the top leadership spot. For that matter, Mr. Takeshita in his run for the LDP presidency in 1987 also was a beneficiary of Mr. Kanemaru's behind-the-scenes influence. Similarly, Toshiki Kaifu, who was plucked from the smallest LDP faction in August 1989 to run as the ruling party's post-Recruit symbol of a "cleaner" LDP, was a beneficiary of Mr. Kanemaru's kingmaking skills (see *JEI Report* No. 31B, August 11, 1989). By the same token, the former LDP vice president had no compunctions about abandoning Mr. Kaifu when his protege proved — in Mr. Kanemaru's eyes — to be an ineffective leader. The former prime minister last October was forced to withdraw from the LDP leadership race in part because Mr. Kanemaru and, thus, the Takeshita faction would not back him (see *JEI Report* No. 38B, October 11, 1991).

Liberal Democratic Party Factions

(Diet upper and lower house membership)

Noboru Takeshita	108
Hiroshi Mitsuzuka	75
Kiichi Miyazawa	73
Michio Watanabe	65
Toshio Komoto	31
Independents	31
Total	383

Sources: *The Japan Times*, July 28, 1992 and Kyodo Wire Service, August 4, 1992.

Even after his election as LDP president and prime minister Mr. Miyazawa found that he still needed Mr. Kanemaru's help. Although Mr. Miyazawa, a faction head, entered office with his own power base and considerable diplomatic experience, his initial months in office were rocky. The prime minister was unable to shepherd through the Diet legislation that authorized Japanese military support for United Nations-sponsored peacekeeping activities. Moreover, the LDP's promised political reform legislation remained stalled, and the prime minister's January summit with President Bush disappointed many in Nagata-cho. By turning to Mr. Kanemaru to serve as LDP vice president and manage party affairs, the prime minister could devote his energies to government policy.

Mr. Kanemaru's resignation from the LDP leadership and his subsequent disgrace at pleading guilty to violating the campaign financing law has prompted speculation in the Japanese press that Mr. Miyazawa now may be more vulnerable to leadership challenges from other segments of the party. No other politician in the ruling party possesses Mr. Kanemaru's political savvy or his fund-raising and brokering skills; thus, none would have as much clout in managing party affairs. Without the "glue" provided by the senior LDP member, some analysts say, Mr. Miyazawa probaby will be undermined in his efforts to build the intra- and interparty coalitions that will be necessary if he wants to enact the legislation on his immediate agenda.

While concurring that Mr Miyazawa might have problems in shepherding legislation through the Diet, other Japanese political insiders are less pessimistic that the prime minister will be forced from office in the near term. Some predict that Mr. Miyazawa will remain in office at least through the end of the year, but most are of the view that he may well serve through next October to complete his full, two-year term.

The prime minister's longevity will depend on whether any one person can mount a credible challenge. At this stage no senior ruling party politician feels secure about making such an attempt due, in part, to the continuing cloud cast by the Sagawa trial. Three of the senior politicians generally considered to be possible successors to Mr. Miyazawa — Foreign Minister Michio Watanabe, former Foreign Minister Hiroshi Mitsuzuka and Mr. Takeshita — are rumored to be on the list of 11 alleged recipients of excessive Sagawa money. Other current cabinet officials who allegedly received money from the former Tokyo Sagawa chief include Posts and Telecommunications Minister Hideo Watanabe and Transport Minister Keiwa Okuda. All these politicians have flatly denied the allegations. Although the Ministry of Foreign Affairs' Mr. Watanabe in recent remarks to the press has insisted that he wants to succeed Mr. Miyazawa, insiders say that his health problems during the past year could deter him from campaigning for prime minister or otherwise trying to hasten Mr. Miyazawa's departure.

Although politics in Japan is reknowned for being unpredictable, Japanese political observers sense that Mr. Miyazawa's likely challengers will bide their time and allow the Sagawa affair to play out more fully; their real hope, of course, is that the scandal will blow over. A challenge to Mr. Miyazawa's leadership before his term is up, analysts say, might happen after next year's lower house elections, particularly if the LDP does not fare well at the polls.

Younger Members Champ at the Bit

The possibility that the ruling party itself could be shaken up as a result of Mr. Kanemaru's weakened position is of key importance, commentators have stressed. The extent to which the former LDP vice president has ceded leadership of the Takeshita group remains unclear, but if, and when, Mr. Kanemaru completely steps aside, many observers expect power struggles to ensue that could cause the largest LDP faction to splinter. Mr. Orr of Temple University Japan predicts that the Takeshita faction will not to be the same as a result of Mr. Kanemaru's "dethronement." "If the Takeshita faction splits," Mr. Orr says, "we will see a new round of factional in-fighting not seen since the 1970s."[3] The breakup of the largest faction, in turn, probably would precipitate a realignment among all the factions, resulting in the expansion of some groups and the disappearance of smaller, weaker units.

Pressures for a realignment within the ruling party actually have been building in recent years due to a generational struggle between the LDP old guard, such as Messrs. Takeshita and Miyazawa, who owe their power to the party's seniority-based factional system, and younger members, who believe the party needs new leadership with fresh ideas and are impatient about waiting their turn. Some commentators contend that Mr. Kanemaru's exit from political center stage simply provides the catalyst for an internal upheaval that long has been in the making. Another possible stimulus for change, according to some analysts, would be if Bill Clinton is elected U.S. president, a situation that might be heralded by some in Japan as an opportunity to rejuvenate Japanese leadership. Seeing Mr. Miyazawa together with Mr. Clinton would emphasize a generation gap, and the Japanese people might feel that they also need a younger, possibly more dynamic, leader. That is a view voiced by Nathanial Thayer of the Johns Hopkins School of Advanced International Studies and others.[4]

Economic Forces Affecting Change

Kent Calder of Princeton University has suggested that developments in Japan's economy are more potent factors for change in the LDP and the political order than personalities or political scandals. Traditional business support for the LDP may be waning because the private sector no longer depends as much on the stability that was associated with the ruling party's uninterrupted leadership during the high-growth period of the 1960s and 1970s, the Princeton University scholar says. Moreover, with the increasing multinationalization of Japanese companies, traditional pork-barrel politics no longer serves as effectively the interests of the business mainstream. Mr. Calder contends that the conflicting pulls of business internationalism and Japan's welfare-oriented domestic system have created a fissure in the ruling party that cuts across faction lines and is bound to tear the LDP apart.[5]

This cleavage, he says, stems, in part, from differences between the Liberal Party and the Democratic Party, the two parties that joined as the Liberal Democratic Party in 1955. Today's so-called "democratic camp" of the LDP tends to approach policymaking in a parochial or "clientalist" manner, the Princeton scholar maintains. Politicians of this bent, who include Mr. Kanemaru and former Prime Minister Kakuei Tanaka among others, usually focus on traditional public works, prime opportunities for pork-barrel initiatives. Over the years this camp has established strong ties with the construction industry, for example, and has tended to resist policies aimed at deregulating the economy. The "liberal camp" of the ruling party supports a hands-off, consumer-oriented, open-market approach to economic management. Mr. Calder regards former Prime Ministers Yasuhiro Nakasone and Kaifu as embracing this philosophy. Since the stability afforded by a unified conservative party is less important to the business community now, Mr. Calder says, it only follows that the forces that have worked to constrain the LDP within its traditional organization and structure will be diminished.

Prospects for New Leadership

In any event, one can conclude reasonably that, whether driven by economic forces or by personalities and factional in-fighting, the LDP old guard is under pressure to change to accommodate the demands of a new crop of political and business leaders. The prime seedbed for leaders of existing or breakaway factions are:

The Takeshita Faction - Former LDP secretary general Ichiro Ozawa, former Finance Minister Ryutaro Hashimoto and current Finance Minister Tsutomu Hata are mentioned most often as representing Japan's next generation of leaders. They all have risen rapidly through the ranks of the Takeshita faction. Messrs. Ozawa and Hashimoto, in particular, are thought to have enough support to break away and form their own groups. Since factions generally function as conduits for campaign funds and power bases for prospective prime ministers, Messrs. Ozawa and Hashimoto presumably would have a shot at the premiership.

As leaders, however, they would have different policy orientations. Mr. Ozawa, coming from the "democratic camp," tends to approach policymaking in a more parochial or nationalistic manner. This could mean that a Prime Minister Ozawa might take a tougher stance with the United States and other countries on trade liberalization issues, for example. Mr. Ozawa also is an unabashed hawk on defense issues. He pushed hard for enactment of the U.N. peacekeeping support bill during the early stages of the Persian Gulf crisis. However, some say he tried to push the still strongly pacifist public too far, too fast on this issue, which might not make him widely popular with the electorate. In addition, he has yet to hold a major cabinet position, such as finance minister or foreign minister, which generally is considered a prerequisite for the post of prime minister. Aside from questions concerning his possible involvement with Sagawa and reported health problems, Mr. Ozawa, who apparently is anxious to lead his own faction, nevertheless may hold off in his drive for the premiership until he has acquired more government credentials.

Mr. Hashimoto, conversely, is from the "liberal camp" of the ruling party, which suggests that as prime minister he may be more open to considering how Japan might continue to liberalize still-regulated industries. As a former member of the Nakasone and Kaifu cabinets the ex-finance minister also possesses a professional portfolio befitting a prime minister. But while telegenic and popular with the public, Mr. Hashimoto was hurt by last summer's stock market payoff scam since this occurred on his watch as finance minister (see *JEI Report* No. 30B, August 19, 1991); he has assumed a lower profile since then. In the foreign policy area Mr. Hashimoto probably would support initiatives that demonstrate Japan's willingness to assume more global responsibility, while being careful not to stretch too far the long-held interpretation of Japan's "peace constitution."

Political observers note that while the current finance minister, Mr. Hata, may not possess the temperment for the backroom wheeling and dealing in which faction heads must engage, he nevertheless is considered an attractive candidate for prime minister. In addition to being liked and respected by members of other factions, Mr. Hata skillfully has straddled the "liberal" and "democratic" camps within the Takeshita faction and, thus, probably could unify the group behind his candidacy. Moreover, his strong advocacy of political reform and effective stewardship of Prime Minister Kaifu's Research Commission on the Election System would play well with the public — although this has made him unpopular with some LDP members. If the Takeshita faction remains unified, his chances for eventual leadership are likely to be high, LDP watchers say.

Other Factions' Candidates - Other Young Turks who aspire to lead the country include chief cabinet secretary Koichi Kato and Yohei Kono, both from the Miyazawa faction. Mr. Kato is considered by some to be the "crown prince" of Mr. Miyazawa's group, although he appears to have become the target of jealousy from other faction members because of his political savvy, professional competence and experience as a member of the cabinet. In addition to his current post he served as director general of the Japan Defense Agency during the Nakasone administration. Since assuming the chief cabinet secretary's position, however, Mr. Kato has been criticized for his management of Diet affairs, particularly the LDP's inability to enact in a timely manner the U.N. peacekeeping support bill. In addition, his name on several occasions has been linked to a political scandal. Earlier this year reports surfaced that Mr. Kato received money from Kyowa Corp., a now bankrupt steel frame manufacturer that also was implicated in the alleged bribery of a former cabinet official and high-ranking member of the Miyazawa faction, Fumio Abe. Although he has an impressive cabinet portfolio and is respected for his foreign policy expertise, Mr. Kato may have too many political negatives to make a bid for the premiership in the near term. Moreover, he does not appear to enjoy a broad enough base of support to split off from Mr. Miyazawa and form his own faction. The chief cabinet secretary probably will continue to wait in the wings until circumstances are more favorable for him.

Mr. Kato's reported rival within the Miyazawa group, Mr. Kono, also is respected for his political savvy. In the mid-1970s Mr. Kono split from the ruling party and formed the New Liberal Club, a very small party that appeared devoted to, among other things, criticizing the money-centered nature of Japanese politics and the LDP's failure to effectively deal with repeated corruption. This group merged with the ruling party in 1986 due to internal disagreements. Mr. Kono evidently is closer to Prime Minister Miyazawa than Mr. Kato is, leading some observers to speculate that he might be tapped as chief cabinet secretary if Mr. Miyazawa reshuffles his cabinet in the near future. (The uncertainty concerning what other names may be revealed, if any, during the trial of Tokyo Sagawa's ex-president or in Diet discussions has complicated the prime minister's plans to reorganize his administration.)

Implications of Smaller Factions

Whether or not Mr. Kanemaru's involvement in the Sagawa scandal actually precipitates a factional upheaval in the LDP, the ruling party nevertheless appears to be ripe for a shake-up. If Messrs. Ozawa and Hashimoto decide to split from the Takeshita faction, their departures could reverberate throughout the ruling party. For example, the smallest faction, headed by Toshio Komoto, might disband, as members align themselves with the Ozawa or Hashimoto groups or the original Takeshita faction. Analysts also speculate that the Mitsuzuka faction may experience some defections if the Takeshita group splinters.

The end result conceivably could be smaller, more numerous, less bureaucratic and less pyramidal factions. Without one group's total domination of party affairs and the leadership selection process, younger, talented members may have more opportunities to secure the premiership. The followers of a breakaway faction chief also probably would enjoy closer personal ties with the new leader and be better able to make their views known on everything from their campaign financing needs to their views on a variety of policy issues. Longtime observers of Japanese politics contend that the ruling party, in general, is a more dynamic entity when factions are not as large as they are today because smaller groups function more efficiently.

Conversely, intraparty rivalries could focus attention on succession issues rather than on policymaking, although the bureaucracy would continue to keep the government running smoothly. Fund-raising also may be harder for smaller groups; that, in turn, might discourage would-be followers from leaving a large faction, particularly one that has healthy coffers. One can surmise that internationally oriented businesses would support a new faction head from the "liberal" wing of the party, while the construction industry and other sectors resistant to deregulation would channel their contributions to Mr. Ozawa or other faction heads with a more parochial orientation. It is unclear, however, whether political contributions will fall off this year and in subsequent years as a result of harder economic times. A general shrinkage in campaign contributions from the business community might make it more difficult for breakaway faction chiefs to establish viable power bases.

At the same time, though, history has shown that the size of a faction has been important for determining the premiership. Analysts have observed over the years an apparent correlation between faction size and LDP leadership; they add that this linkage has deterred a splintering of the groups.[6]

Mr. Ozawa and other would-be faction heads/prime ministers no doubt are weighing these factors carefully and, in the final analysis, just may decide not to rock the boat for the time being. Even a do-nothing approach — a scenario that appears unlikely given the current political backdrop — would not be surprising in the turbulent, unpredictable world of Japanese politics.

Outlook: Same Game, New Players

Despite the excesses of Japanese politics that have been highlighted again by the Sagawa affair, political observers contend that the political game in Japan still will be played in the same way, with money remaining the prime lubricant of politics. Analysts are skeptical that Mr. Miyazawa will be able to realize enactment of political reforms that would diminish the importance of money in politics, primarily because many members of his own party have too much vested in the current arrangement. If any legislative initiative is pursued as a result of the Sagawa scandal, they add, it may focus on regulating more tightly business contributions to politicians and/or policing relations between elected officials and organized crime groups.

In terms of policy implications LDP members will be so preoccupied with internal jockeying and leadership struggles that in the near term they probably will rely even more on the bureaucracy for policy development, particularly in the foreign policy area. For the United States and Japan's other allies this would ensure continuity in the near future. If a new factional arrangement firms up, whoever then becomes prime minister may try to leave a more discernible imprint on domestic and foreign policy. At that point the politicians themselves may become more engaged in substantive debate.

It still is unclear what a reorganization of the ruling party would mean for the LDP's relations with the opposition parties. Among the new generation of potential leaders no one appears to possess the interparty contacts and bridge-building savvy for which Mr. Kanemaru has been lauded and relied on. If, after the 1995 upper house elections, the opposition parties still dominate this chamber, an LDP-led government without an operative like the former LDP vice president might have a harder time negotiating deals. In particular, this could affect securing enactment of legislation that would reconsider the meaning of Japan's self-defense mission or other bills that differ in spirit from the opposition parties' platforms.

While the Sagawa scandal might not by itself bring about changes in Japan's system of politics, circumstances are ripe for destabilization of the current system. The absence of a bridge-builder of the likes of Mr. Kanemaru plus the strength of second-string quarterbacks and the evolving interaction of the business and the political worlds could provide the appropriate setting for a realignment in the political system. The lack of a leadership option among the political opposition only underscores the prospect for impending change within the LDP.

For further information, contact **Barbara Wanner**.

Notes

[1] Telephone interview with Robert M. Orr Jr., Temple University Japan, Tokyo, Japan, September 28, 1992.

[2] T.R. Reid, "Light Penalty In Japanese Payoff Case," *The Washington Post*, September 29, 1992, p. 1.

[3] Orr, *op. cit.*

[4] Telephone interview with Nathanial Thayer, Johns Hopkins School of Advanced International Studies, Washington, D.C., July 30, 1992.

[5] Telephone interview with Kent Calder, Princeton University, Princeton, New Jersey, September 21, 1992.

[6] Nathanial B. Thayer, lecture before the Japan-America Society of Washington, Washington, D.C., January 31, 1990.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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JAPAN · ECONOMIC · INSTITUTE

JEI REPORT

A Two-Part Report: A and B

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Yen Hits New High

The event was a long time coming, but the yen finally has established a new high against the dollar. On several occasions beginning in early 1988 the Japanese currency had threatened the ¥120 barrier, only to fall back. But on September 28 it finally broke through, beating the old record of ¥120.45=$1.00 set on January 4, 1988, to close at ¥119.65. On the following day the yen went still higher, closing at ¥119.2 in New York, the highest value to date for the yen in the postwar era. As such, the value of the Japanese currency was more than three times the fixed rate of ¥360=$1.00 that prevailed between 1949 and 1971.

Officials on both sides of the Pacific are likely to welcome the yen's strength as a means of reducing Japan's growing trade and current account surpluses on both a bilateral and a worldwide level. A more valuable yen, the argument goes, induces Japanese companies to raise their dollar-denominated prices, thereby leading to smaller sales volumes and lower export values. Skeptics note that this argument seemed to work better in theory than in practice during the 1985-1988 run-up in the yen's value. Although the Japanese currency virtually doubled in value against the dollar during that period, Japan's big trade surplus barely budged, or so it seemed. Those backing this theory are likely to question whether events will unfold any differently this time, even if, as some experts have argued, the yen were to quickly reach ¥110 to the dollar or even higher.

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Current evidence suggests that a strong yen over a sustained period would surprise the skeptics with its effect on Japan's external accounts. This conclusion derives in part from the fact that the previous round of yen appreciation did have a large effect on the current account, as the Table illustrates. After peaking at 4.2 percent of Japan's gross national product in 1986, the nation's overseas account (which is equal to the current account) had dropped 71.4 percent on this basis by 1990. Last year's rise returned this ratio to half the level of 1986. (Dollar-denominated imbalances show a different pattern, a result of using a shrinking yardstick. For descriptions of various trade measures, see *JEI Report* No. 15A, April 19, 1991.)

Financial Deficit or Surplus by Sector

(percent of nominal GNP)

	1965-74	1975-84	1985	1986	1987	1988	1989	1990	1991
Nonfinancial Businesses	-7.1%	-2.9%	-1.8%	-1.3%	-2.2%	-4.5%	-6.7%	-9.0%	-6.8%
Households	9.4	10.2	9.7	10.1	7.8	7.4	9.1	9.8	8.4
Public Sector	-2.6	-7.1	-4.1	-4.1	-1.4	0.6	0.6	0.8	0.7
Financial Sector	1.0	0.6	-0.2	-0.5	-0.6	-0.8	-1.0	-0.4	-0.2
Overseas*	-0.7	-0.8	-3.6	-4.2	-3.6	-2.7	-2.0	-1.2	-2.1

*A negative sign indicates that foreign demand for funds exceeds foreign supply, a situation identically equal to a current account surplus.

Source: Bank of Japan

If anything, a substantial appreciation of the yen would have a greater effect now than it did in the 1985-88 period. Those years marked a reversal from the early 1980s, during which the yen arguably had been undervalued against the dollar. Hence, the yen's initial rise vis-a-vis the dollar was absorbed easily, with exporters making relatively small price adjustments in foreign markets. The yen's move to ¥120 and above, however, would occur from a base that already represents substantial appreciation from 1985 levels. And, unlike the previous period, both domestic and export markets are now weak. In 1986, for example, Japan endured a mild recession, but the growing U.S. economy absorbed a large volume of exports. In 1992 not only is the U.S. economy struggling but the Japanese economy itself is suffering through a downturn likely to be worse than the one in 1986. These factors suggest that Japanese companies might act more aggressively than they did previously to maintain short-term profits by raising prices or reducing their presence in foreign markets. Either action would lead to a relatively quick and large downturn in export volume. Hence, the current account surplus would shrink even faster than it did between 1985 and 1988.

But is the yen poised for another significant ascent? The data in the Table suggest that the answer is "no." In 1986 corporate plant and equipment spending was very weak, as evidenced by the fact that nonfinancial businesses absorbed savings equal to a mere 1.3 percent of GNP. During the ensuing boom years the excess demand for funds in the corporate sector rose, peaking at 9 percent of GNP in 1990. The demand for capital at home reduced the supply of yen on international markets, sustaining the yen's appreciation.

In 1991 and this year, however, the corporate financial deficiency has shrunk considerably, corresponding to a rise in the overseas balance to 2.1 percent of GNP in 1991 and an estimated 3 percent in 1992. With corporate plant and equipment spending projected to remain weak in 1993, this trend is not likely to reverse soon. Despite shrunken government surpluses that reduce the supply of funds available, capital outflows in some form will continue to grow. These arguments suggest that, other factors equal, the supply of yen on international markets is likely to expand, putting downward pressure on the Japanese currency. Not surprisingly, therefore, most experts expect that the yen's trajectory over the next few months is unlikely to be straight up. In fact, there is a fair chance that the Japanese currency could fall back substantially from its recent high.

Douglas Ostrom

Tokyo's "Employment Adjustment" Counters Downturn But Raises Questions

Admitting that the domestic economy is in a deeper rut than predicted, Tokyo has moved to help companies cut labor costs while at the same time ensuring that labor resources are utilized more fully. The central government has turned to a time-tested tool to achieve this aim: the employment insurance system. Even though countercyclical fiscal policy and employment adjustment programs are common in the United States and European countries, Tokyo's past moves to cushion domestic firms from the harsh realities of economic downturns have generated foreign criticism. Whether such criticism is forthcoming during the current recession may depend in large part on which industries Tokyo helps.

On-the-job worker training and retraining long have been important tools used by Japanese management to improve labor productivity. Also important for large companies is the practice of lending underemployed workers to subsidiaries or affiliated companies during slack periods; the lending company continues to cover the entire or a substantial share of the pay of the employee who is on loan. The Human Resources Development Promotion Law of 1969 is aimed at easing the burden of these measures on businesses. Amended in 1985 and 1991 with an eye toward changes in the labor force caused by internationalization, the projected aging of the Japanese population, technological change and expansion of the services industry, the law imposes a tax on all companies equivalent to 0.35 percent of an employee's wages or salary (construction firms pay 0.45 percent) to fund partial government assistance for worker training, employment adjustment and other related programs set up by individual companies. (For details of this and other government programs aimed at helping firms meet changing labor needs see *JEI Report* No. 29A, July 31, 1992.) Through a trade association or similar group a majority of firms in an industry must apply to the government to receive employment adjustment program funds.

On September 29 the Ministry of Labor announced that companies in 10 industries would be eligible for employment adjustment assistance for one year beginning October 1. Included are makers of: plywood, fireproof materials (including bricks), four categories of steel, fabricated steel products, fabricated nonferrous metal products (excluding die-cast), ball and roller bearings, and computer software. The ministry expects another 10 industries to apply for assistance before the end of the current fiscal year next March. The machine tool industry reportedly is polling its members on whether to apply for assistance. The Labor Ministry estimates that the 10 recently approved industries cover 5,100 companies with 476,000 workers and, together with two industries already covered, will bring disbursements for employment adjustment and retraining to as much as ¥2 billion ($16 million at ¥125=$1.00) in FY 1992, several times the previous fiscal year's figure.

Despite the fact that the program is funded by corporate taxes and that the total amount of aid is small, Tokyo's action could arouse foreign ire. With Japan's trade surplus climbing toward a record annual high and foreign economies still mired in recession, any government help to industries that export is an easy target for foreign criticism. During previous economic downturns and periods of economic structural adjustment, Washington warned Tokyo not to soften the blow to domestic companies for fear that such assistance would slow or limit the market-driven adjustment process. With Europe pondering its future as an economic bloc and the United States in the last leg of a

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Bailouts By Japanese Banks Multiply

A key deadline for demonstrating financial soundness looms less than six months away, and Japan's big internationally minded commercial banks might be breathing more easily than they were just two months ago. At that time the Tokyo stock market's two-and-a-half-year downward spiral was imperiling the banks' goal of achieving capital equal to 8 percent of assets by March 31 of next year — an objective set for the world's big banks by authorities under what has become known as the Bank for International Settlements requirements. As a result of the recovery of the Tokyo stock market through the end of September, the March 1993 capital-assets goal appears within reach for the 14 large Japanese banks that are either nationwide commercial banks or long-term credit banks. However, the banks find themselves facing an array of new problems involving dozens of troubled companies that threaten to drown out any applause they otherwise might get six months from now.

Financial sources cited by *Nihon Keizai Shimbun*, the economic daily, say that Japan's major banks had capital equal to 8.7 percent of assets as of September 30. Although details were unavailable on which banks, if any, were under the 8 percent threshold, the ratio suggests that, at least for the average large bank, the BIS requirements will not be a problem unless the Tokyo stock market takes a substantial tumble before the end of March. Such a reaction could reduce substantially the 45 percent of paper securities profits that banks are allowed to count as capital. In reaching 8.7 percent, the banks also got a boost from the weak dollar, which reduces the reported yen value of dollar-denominated assets, and from capital raised in the form of subordinated loans.

Of course, major Japanese banks have seemed on the verge of meeting the 8 percent goal previously, only to see the prospect of achieving it recede along with the stock market. Given the continued volatility of the Tokyo market, that possibility cannot be dismissed, but more immediate problems loom larger for the banks. Japan's 11 city or nationwide commercial banks and three long-term credit banks sit at the top of a pyramidal banking structure, the bottom portions of which are looking increasingly shaky. As exemplified by loans to specialized housing finance companies (see Table), which face extreme financial difficulties as a result of lending for speculative real estate deals, nationwide commercial banks would appear to be little affected. Arguably facing the worst problems are some parts of the agricultural cooperative credit system, which is based on thousands of tiny credit associations throughout rural Japan. (Lack of comparable data may somewhat overstate the problems of the agricultural cooperatives relative to other financial institutions, however.)

Loans to Five Major Japanese Housing Finance Companies

(in billions of yen as of June 30, 1992)

	Loans to Housing Finance Companies	Total Lending	Share
Nationwide Commercial Banks	¥1,225.7	¥219,930.3	0.6%
Long-Term Credit Banks	1,254.0	47,619.4	2.6
Trust Banks	2,083.3	22,627.5	9.2
Agriculture-Related Financial Institutions*	4,392.1	31,300.2	14.0

*Include Norinchukin Bank plus Mutual Insurance Federations of Agricultural Cooperatives and Credit Federations of Agricultural Cooperatives. Data on total lending for the Mutual Insurance Federations of Agricultural Cooperatives are as of May 31, 1992.

Sources: Compiled from data in *Nihon Keizai Shimbun* and from Bank of Japan.

The figures in the Table also show that Japan's long-term credit banks and seven trust banks have a much larger combined exposure relative to total lending than the major commercial banks, a situation said to exemplify the general problems of long-term credit and trust banks in that both groups of financial institutions have close connections with Japan's 64 first-tier and 66 second-tier regional banks. Some of these latter institutions face severe problems in their loans to nonbank affiliates. As such, they have looked to the long-term credit banks and the trust banks for help.

However, neither group of potential saviors of regional banks is that healthy itself. The problems of Nippon Credit Bank, Ltd., the third-largest long-term credit bank, is a good case in point. Nippon Credit's problems with its financially troubled nonbank subsidiaries required the coordinated assistance of about 90 Japanese financial institutions, with the Norinchukin Bank, the apex of the agricultural credit system, a notable holdout (see *JEI Report* No. 37A, October 2, 1992). For their part, trust banks are caught on the wrong end of the yield curve. Trust banks make extensive use of long-term financing, the cost of which has declined less than that of short-term credit — likely to be favored by the nationwide commercial banks. Hence, the profitability of trust banks has lagged that of their larger rivals.

For trust banks the precedent established by Nippon Credit's problems with its nonbank subsidiaries is troubling. As a result of that agreement, financial institutions accepted dramatic cuts in the interest rates they charge the distressed companies, even in situations where they were not the main bank (traditionally defined to be the bank that extends more than 10 percent of a firm's total credit). Comparable situations were not long in emerging. For example, Hyogo Bank, Ltd., the

14th-largest regional bank, in early October reportedly asked four trust banks and other large Japanese banks to apply the discount rate on existing loans to three of its troubled nonbank subsidiaries. The discount rate, currently 3.25 percent, is the price of loans to banks from the Bank of Japan and is far below most short-term interest rates, particularly those charged for risky loans.

Of ¥873.2 billion ($7 billion at ¥125=$1.00) in loans outstanding to the three nonbank subsidiaries of Hyogo Bank as of August 31, Hyogo Bank itself accounted for 10.1 percent. The four trust banks collectively had 24.6 percent, with the largest individual share among them being the 7.6 percent share held by Sumitomo Trust & Banking Co., Ltd. Since the trust banks' cost of long-term funds exceeds 5 percent, the proposition of lending money at 3.25 percent would appear to be a nonstarter. Yet the trust banks may have no choice but to comply. Total loans to the three nonbanks from all institutions equal roughly one-third of Hyogo Bank's total lending, indicating that the regional bank alone would have great difficulty carrying the burden of below-market interest rates.

The effect of the Nippon Credit, Hyogo Bank and numerous other bailout cases increasingly is to shift the burden of troubled companies up the financial pyramid to big commercial banks, a situation rendered more likely to the extent that trust banks stiffen in their resistance to requests for financial assistance. Given the case-by-case approach being used with respect to troubled nonbanks, housing finance companies and even second-tier securities companies, the extent of the ultimate burden on the city banks remains unclear. As evidenced by the lower credit ratings of Japan's nationwide commercial banks after reassessments from international credit rating organizations, the ranks of doubters concerning the health of even the largest banks have increased this year. Achieving the 8 percent BIS standard next March, by no means a foregone conclusion, would be a much-needed feather in the caps of bankers at these institutions.

Douglas Ostrom

Plutonium Transport Mission Attracts Critical Mass

The chorus of foreign and domestic voices critical of the Japanese government's plan to ship plutonium fuel from Europe to Japan is growing louder and fuller. A specially fitted Japanese transport vessel, which began its first mission August 24, reportedly still is at sea. Despite the criticism, Tokyo seems determined, at present, to move ahead with its plan to bring 30 tons of recovered plutonium and uranium waste from Europe to Japan over the next two decades. The government considers the radioactive element a critical component of its ambitious nuclear power development program. The plan's repercussions, however, extend far beyond the immediate concerns over the safety of the shipment into the field of foreign policy.

Tokyo projects that Japan's nuclear power industry will burn 80 to 90 tons of plutonium fuel over the next several decades. This projection is in line with government plans to raise the share of electricity generated by nuclear power plants from the 26.7 percent contributed in FY 1991 to well over 30 percent within the next 15 years. When Tokyo drew up a master plan for nuclear power in the 1970s the high cost of uranium and concerns over secure access to the fuel focused attention on developing a "closed" nuclear fuel cycle that employed breeder reactors and plutonium fuel. While Tokyo is striving to develop an indigenous plutonium reprocessing capacity, much of the radioactive and highly toxic fuel needed for the country's nuclear plants during the next two decades will come from French and British reprocessing facilities. These plants extract plutonium from spent uranium fuel removed from Japanese nuclear facilities.

Because the enriched nuclear fuel used by Japan's nuclear power industry comes from the United States, Washington retains a say in its transport and use. Tokyo has consulted closely with the Departments of Energy and Defense and has obtained the Bush administration's approval of its plans to return recovered plutonium to Japan via ship.

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ROLES OF GOVERNMENT, INDUSTRY IN THE LIFE OF DISABLED JAPANESE

SUMMARY

How a society treats citizens who have disabilities gives an insight into the kinds of civil rights policies that a government will adopt and industry follow. While Japan does not have the equivalent of the new Americans with Disabilities Act, termed a civil rights act for people with handicaps, various laws do address the responsibility of government to provide for society's welfare and the rights of Japanese citizens to employment and equal opportunities in education.

Foreign influences have helped raise awareness about untapped resources among the disabled in Japan, where the image of people with disabilities being hidden away is being dispelled gradually. A healthy economy also has enabled Japan to improve both job opportunities and economic assistance for disabled people in recent years.

A spotty pattern of improvement in facilities that allow easier access for people with physical handicaps underscores the uneven distribution of opportunities for disabled people in Japan. Moreover, not all those with disabilities have made advances. People with mental illness or mental retardation have made less progress toward participation in the mainstream than those with physical limitations.

At the heart of questions about how well people with disabilities fare in Japan is how much the members of society, both those with handicaps and those without, should be protected. Strong overtones of paternalism color Japanese regulations, with debatable consequences of good or ill for society as a whole. Adding to the debate is the question of whether the perils of paternalism outweigh the risks that those who are the least able to survive on their own might be ignored under a philosophy of mainstreaming.

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Disability, A Fact of Life

Even if all people were born without any physical or mental defects, disabilities would arise from accidents, illnesses and other unintended or even intended occurrences, such as war. The latest government survey to determine the number of people with physical disabilities in Japan, taken in 1987, listed 2.6 million people, about 2 percent of the population. Given a history in which many Japanese with disabilities have been kept at home and "hidden away," some observers feel this ratio is too low. Americans with disabilities, for example, make up about 17 percent of the U.S. population. Statistics are unavailable on Japanese with mental disabilities, since concerns about privacy and human rights violations led to the discontinuation of such reviews. Based on the last overall survey of people with mental illness or mental retardation, conducted in 1963, the government estimates that mental disabilities affect about 1.6 million Japanese, or 1.3 percent of the population. These figures, too, may be low; internationally recognized trends lead psychiatrists to calculate that schizophrenia alone affects 1 percent of every population, while depression impacts an estimated 5 to 6 percent.[1]

The majority of physically disabled Japanese are handicapped because of a limb or body trunk impairment considered severe enough to interrupt daily activities. This group accounts for roughly 60 percent of the disabled population. Another 13 percent have severe visual impairment; 15 percent have hearing or language disabilities; about 12 percent suffer from permanent internal disorders, such as heart or lung deficiencies. An estimated 7 percent have multiple physical impairments. The mentally disabled include both the people with mental retardation and those suffering from schizophrenia or other mental illnesses.

Most often cited as a source of physical disability in Japan is toxic, infectious or some other disease; roughly 64 percent of the disabilities noted in the 1987 study resulted from this cause. Disease was the culprit in more than 70 percent of the cases of disabilities among children that year, with cerebral palsy the predominant problem. Other reasons for disability included accidents (21 percent overall and 4.7 percent for children); what the government describes as injuries at birth (4 percent overall and 32.7 percent of disabled children); and wartime injuries and illnesses (3.8 percent overall). An unspecified "other" caused 9 percent of overall disability and 13 percent of children's.

Despite a substantial decline during the past 10 years in the number of work-related accidents and illnesses sufficient to trigger workers' compensation payments,[2] the number of Japanese impaired by other causes is expected to continue to increase (see Table 1). Advances in emergency medical services and general medical care mean more injured people will survive accidents and diseases, although they may be temporarily or permanently disabled. As the population ages, the elderly, who are at greater risk of incapacitating disabilities, can be expected to comprise more than half the number of people with disabilities. Senior citizens made up 58 percent of the disabled population in the government's 1987 survey; moreover, cerebrovascular disease, estimated as the cause of 14.7 percent of the disabilities that year, primarily affects older adults.

Table 1: **Percentage of Japanese Population with Physical Disabilities, 1960-87**

	1960	1965	1970	1980	1987
Number (in thousands)	829	1,048	1,314	1,977	2,413
Share of Population	0.8%	1.1%	1.2%	1.7%	2.0%

Source: Japanese Society for Rehabilitation of the Disabled, *Rehabilitation in Japan 1988*, p. 39.

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Increasing numbers of physically disabled adults are living in institutions, in part because more facilities are available today than 10 years ago. One concern is that no effort is being made at rehabilitation in some of the care centers; thus, residents become institutionalized. Care-oriented institutions tend to outnumber rehabilitation centers in Japan (see Table 2). Conceivably, adequate rehabilitation could help minimize the number of disabled. Whether the increase in physically disabled adults in institutions stems from an increase in numbers of people with disabilities or possibly greater severity of disabilities or societal factors is uncertain, however. Demand may be greater than in the past because smaller homes (due to urbanization and the high cost of housing) plus fewer helpers at home (as more women enter the work force and more family units reflect two rather than three generations) add to the difficulties of keeping those with disabilities in the home. Supply also

Table 2: **Facilities for Physically and Mentally Disabled Japanese, 1989**

	Number of Facilities	Capacity	Admitted	Staff
Residential Institutions for Children				
With mental retardation	309	19,921	17,067	10,893
With autism	8	380	316	573
Who are blind	22	1,167	400	413
Who are deaf and mute	20	1,179	311	337
Hospitals or homes for disabled children	72	8,877	6,325	7,091
Hospitals or homes for children with severe mental or physical disabilities	62	6,677	6,397	8,081
National sanatoria with beds for children with severe mental or physical disabilities	80	8,080	7,753	--
National sanatoria with beds for children with progressive muscular atrophy	27	2,140	1,215	--
Rehabilitation homes for disabled children	8	425	268	233
General Residential Institutions				
For people with mental retardation	829	57,086	56,264	28,942
Welfare homes for physically disabled	9	--	135	--
Custodial care homes for physically disabled	203	--	12,881	--
Sheltered workshops for people with mental retardation	173	11,075	10,832	4,803
Sheltered workshops for physically disabled	84	--	4,607	--
Sheltered workshops for severely physically disabled	119	--	7,550	--
Day Care Facilities for Children				
With mental retardation	216	7,885	6,070	3,607
With mental and physical disabilities	237	4,740	--	--
With disabilities (unspecified)	71	3,010	2,336	1,372
Who are hard of hearing	27	905	723	403
General Day Care Facilities				
Rehabilitation centers for mentally retarded	117	4,362	4,079	1,596
Sheltered workshops for mentally retarded	369	13,453	12,852	4,431
Additional Special Needs Housing				
Reserved for people with mental retardation	39	420	356	99
Hostels for employees with mental retardation	102	2,430	2,293	622

Source: Ministry of Health and Welfare, *Annual Report on Health and Welfare, 1990-1991*, pp. 277 and 282.

could be a factor in institutionalization. The government has responded to concerns about the aging of the population, for example, by pressing for more nursing homes, although the number still is considered inadequate to meet demand. (For a look at Japan's policies on long-term care and aging, see *JEI Report* No. 14A, April 10, 1992.) The government encourages senior citizens to stay out of institutions and in homes by such measures as subsidies for helpers who assist in daily living activities at the homes of the elderly and people with disabilities. However, the scarcity of these helpers and the variations in staffing around the country leave little assurance that everyone who wants help gets it.

Most physically disabled Japanese do live at home; an estimated 93,000 of the 2.4 million adults with disabilities were in institutions in 1987, and 13,000 of the 92,500 disabled children under age 18 at that time lived in an institution. The Japanese Society for Rehabilitation of the Disabled points out that, in contrast to the increase in institutions for physically disabled adults, the number of institutions for children with hearing or visual impairment has decreased. The group attributes this drop to a diffusion of education facilities, more community-based services and, in general, increased mainstreaming, a concept in which those with disabilities are integrated into the normal routines of society. The rehabilitation advocacy group notes, however, that there are more facilities for children with severe disabilities. As an indication of the dissatisfaction with institutions that serve a minimum of 50 people and have grown into large facilities often remote from communities, the advocacy group says that more small-scale residential facilities are being established, particularly small sheltered workshops not authorized by the government.[3]

Government Helps Reshape Attitudes Toward Disabled

Before World War II and even as recently as the late 1970s Japanese with physical disabilities were seen rarely in public. This situation is changing gradually, as physically handicapped Diet members and efforts by advocates for the disabled -- foreign and domestic -- help make disabilities appear somewhat more commonplace. A critical difference from prewar days is a new outlook in Tokyo. Now required by the postwar constitution to accept primary responsibility for seeing to the welfare of society, the government's approach is in stark contrast to prewar welfare laws that listed families as the first recourse to help people with disabilities and then neighbors, with assistance from the government extended only as a last resort. In general these early provisions -- no different from some public safety laws then current in the West -- conveyed a feeling of "chastising the lazy and protecting society," according to a review of rehabilitation in Japan published in 1988 by the Japanese Society for Rehabilitation of the Disabled.[4]

Even after the postwar constitution went into effect and the government assumed responsibility for meeting citizens' social welfare needs as well as providing education and employment opportunities, progress was slow for people with disabilities. A Daily Life Security Law, passed in 1946 and revised in 1950, regulated institutions that served public aid recipients, including those with disabilities. The Japanese National Committee of the International Council on Social Welfare has noted, "The most important characteristic of the old Daily Life Security Law was that it clearly stated for the first time the principle of equal justice and nondiscrimination under national responsibility."[5]

Several laws referring to employment or vocational training for disabled people were passed and revised, starting in 1947. After a 1952 plan calling for greater employment of the disabled apparently generated little action, the Diet passed the 1960 Physically Handicapped Persons' Employment Law -- legislation that recommended quotas for various employers to meet in hiring those with physical disabilities. This law, too, was not considered effective. In 1976 the quota system became mandatory, although companies can obtain exceptions. Fines are levied on firms not in compliance. A 1987 revision of the law covered people with mental retardation.

These efforts to bring people with disabilities into the work force correspond to the concept of mainstreaming. The idea of integrating people with disabilities into every day life underpins the 1990

Americans with Disabilities Act, for example, which provides to people with disabilities a civil rights guarantee to equal access in employment, public accommodations, public services, transportation and communications. Although the job quotas in Japan do not mandate equal job opportunities, they encourage mainstreaming more than does Tokyo's application of its constitutional mandate for equal opportunities in education. The constitution states: "Equal opportunity for education has to be given to all nationals regardless of their race, beliefs, social status, financial status or family background." In practice this provision has evolved into an idea of "separate but equal." The first special education schools opened in 1948 and served children with visual and auditory handicaps. Four years later the Ministry of Education tackled educating children with other handicaps by creating a Special Education Office. This office also was asked to determine why attendance had been so low in the new schools for visually and hearing impaired children. As noted by the Japanese Society for Rehabilitation of the Disabled, "[L]ack of understanding of the objectives of compulsory education, and the effect it would have upon the children" meant that "some families tried to hide their children away, [while] others didn't want their children to leave home to receive education." But a more practical reason was financial, the group says, noting that the scarcity of special education schools meant children either had to commute daily, perhaps with paid attendants or accompanied by the parents themselves, or be housed away from home in dormitories.[6]

By 1979 the government had in place what it considered to be a sufficient number of special education schools in all prefectures to make education compulsory for children with handicaps; exceptions are granted for the most severely disabled. Although special classes at regular schools are encouraged for students with mild disabilities, schools do not have to provide such classes. By the time officials had mandated creation of special schools for all handicapped students, however, a grass-roots movement had been underway for 14 years to encourage integration in schools, particularly kindergartens and day care centers. The debate over separate institutions continues to this day. Citing the ability of special schools to design facilities and curriculum to meet the needs of students with disabilities, local governments have been known to refuse admission to regular public schools even if the handicapped students have passed a difficult entrance exam. This year a district court in Kobe issued a ruling favorable to the philosophy of mainstreaming when it ordered the nullification of a city's refusal to allow a wheelchair-bound student into a regular high school. The Amagasaki city assembly had questioned whether the student would be able to attend three years of school, based on his physical records, and had suggested that he would fare better at a school with facilities for the handicapped.

Not all school authorities have responded as the Amagasaki assembly did, but integration remains somewhat uncommon. The Ministry of Education reported that, of the 18,752 students who graduated in 1990 from junior high classes for the handicapped or schools for the blind, deaf or disabled, only 12.5 percent (2,340) went on to enroll in regular high schools or technical schools.

In providing "separate but equal" schools and recreation facilities Tokyo follows a paternalistic, protection-oriented approach rather than one that suggests integration will improve understanding of people with disabilities and, thus, increase their opportunities. The latter philosophy, as mentioned above, guides the Americans with Disabilities Act. No stranger to U.S. trends, Japan has been made more aware of the implications of this act recently by domestic and foreign efforts to encourage consideration of a comprehensive civil rights law in Japan.

Inspiration from Abroad

Both U.S. and European attitudes toward people with physical disabilities have made strong impressions on the Japanese. In fact, a rude shock delivered by American and European athletes to their Japanese counterparts at the 1964 Paralympic Games for physically handicapped athletes in Tokyo is credited with helping open the eyes of disabled Japanese to their own potential. The discovery had nothing to do with athletic skill, but everything to do with lifestyle. "U.S. and European paraplegics [at the games] all had their own job [in their own country]. All of the Japanese were from hospitals, outside the community," recalled Ichiroh Maruyama, who had worked as a volunteer translator at the Tokyo games and now is director of the Department for the Welfare of Disabled Persons in the National Council of Social Welfare. "The Japanese were so shocked that in 1964 even though they were athletes, they were stuck in social institutions."[7] The rights of people with disabilities became the theme for several study groups, assemblies and conferences meeting in the late 1960s.

The 1964 Paralympic Games also moved one American to take a hand in hiring handicapped Japanese at his company in Japan. Justin Dart, who now heads the President's Committee on Employment of People with Disabilities, in the mid-1960s ran Tupperware operations in Japan for Dart Industries Inc. "We took 11 men from institutions into our company and started an independent-living program," Mr. Dart recently recalled, noting that the noninstitutional residence for the disabled men, who had been living in full-care institutions for between three and nine years, was the first of its kind in Japan. "The thing that I remember," he added, "All the things we did — even though there was emotional opposition by the doctors to the way we did it (we did not ask their advice any more, we just went off and did it) ... — all [these activities] had fundamental support. There was resentment but, nevertheless, they did cooperate."[8]

Mr. Dart has continued to prod authorities in Japan to take a new look at people with disabilities. In September the wheelchair-bound former businessman spoke at a conference arranged by IBM Japan Ltd. on full participation of people with disabilities in society. Calling for Japan to institute a civil rights law comparable to the Americans with Disabilities Act, passage of which he spent at least eight years promoting, Mr. Dart criticized conditions of partial equality, describing them as "intolerable to people with disabilities in Japan" as "[a]partheid is intolerable to Africans ... [and] to the world."[9] Undeterred by the noncommittal responses, Mr. Dart said he sees potential for change. Arguing against people who have said Japan lacks a civil rights tradition, he contended in a recent interview that those who predicted democracy would not work in Japan after World War II "because of no democratic tradition" have been proved wrong by what he calls "the best democracy in the world." If the Japanese decide they can do it, he added, "[they] will do it and do it better."[10]

Industry's Responses to the Disabled

When the Diet made mandatory in 1976 the previously voluntary hiring quotas for people with physical disabilities, industry responded initially by saying the requirements would make them less competitive, according to Mr. Maruyama of the government-authorized National Council of Social Welfare. Government sweetened the mandate, however, by funneling the fines instituted for noncompliance into grants to companies that meet their quota. The dual purpose of the grants is not only to help companies adapt their facilities to accommodate persons with handicaps but to encourage employment of those with disabilities. Under another program the government offers grants to subsidize up to two-thirds of large companies' wage payments to people with disabilities and three-fourths of smaller companies' wage payments for a period of up to 18 months. Government-subsidized vocational training programs incorporate training of those with disabilities. Plus, government employment offices work with industry to promote the hiring of people with disabilities.

One of industry's complaints about regulatory implementation of the Law for Employment Promotion of the Disabled is that only those disabled who work 33 hours or more a week count toward meeting a company's quota. The Ministry of Labor has said it plans to introduce next April revised standards that allow the hiring of people with disabilities who work at least 22 hours a week to satisfy quota requirements. The revision will mean that employment of a disabled person who works between 22 and 33 hours each week will count toward a company's quota. People with handicaps who put in 33 hours a week or more will count for two positions. For each person with severe mental retardation who is hired a company also can tally up two positions toward its quota. Although the new rule can be viewed as encouraging the hiring of disabled employees who might prefer fewer work hours, the other side of the coin is that companies can achieve their quotas by hiring fewer disabled persons or limiting the hours even if a person with disabilities wants to work a longer week.

Under the current system a company that employs 63 or more people is required to hire 1.6 percent of its regular work force from the disabled population. Both government and quasipublic corporations have higher quotas. As an employer government is required to draw 1.9 percent of its nonclerical staff and 2 percent of its clerical staff from among those with physical or mental disabilities. A quasipublic body's quota is for 1.9 percent of its clerical and nonclerical staff to be disabled. Compliance among all firms is improving, but a June 1992 Ministry of Labor review found 48.1 percent noncompliance. Large corporations' ratio of employees with disabilities was 1.23 percent, while all firms averaged 1.36 percent. Quasipublic bodies met their quota this year and have shown the greatest increase, starting at 0.95 percent in 1977. For the first time this year manufacturers as a group achieved the hiring target, according to Ministry of Labor figures. The ministry attributed the all-time high number of disabled people holding jobs, 229,627, to stricter guidelines under which the ministry began announcing the names of firms that had done nothing to try to hire people with disabilities or change their employment policies to accommodate such hiring.

The government had accumulated ¥24.4 billion ($194.9 million at ¥125=$1.00) by FY 1991 from noncompliance levies and made that money available to firms meeting their quota (see Table 3). Employers of more than 300 workers face levies of ¥50,000 ($400) per month for every position short of the quota. But those companies that meet their quota get rewards. A firm with a payroll of 300 or more employees can get adjustment grants of ¥25,000 ($200) per month for each person hired to meet the quota; for smaller firms the payment is ¥17,000 ($136) per person per month. Examples of how firms put their adjustment grants to work are shown in Table 4.

Table 3: **Revenues and Expenditures for Programs Employing the Disabled, FY 1985-FY 1991**

(in millions of yen)

	FY 1985	FY 1986	FY 1987	FY 1988	FY 1989	FY 1990	FY 1991*
Revenues	¥18,098	¥18,434	¥18,571	¥19,873	¥24,539	¥27,071	¥27,853
Levies	17,565	17,626	17,716	18,515	22,436	23,484	24,358
Other	533	808	855	1,358	2,103	3,587	3,495
Expenditures	13,600	12,646	12,712	13,683	17,214	24,778	31,822
Grant/Reward Program	11,925	10,740	10,670	11,417	14,749	22,017	27,803
Adjustment Grants	2,751	2,871	2,866	2,847	2,808	2,908	3,005
Rewards	1,576	1,541	1,517	1,507	2,194	3,518	3,709
Grants	7,598	6,328	6,287	7,063	9,747	15,591	21,089
Operational Costs	1,592	1,798	1,908	2,104	2,350	2,613	3,846
Other**	83	108	134	162	115	148	173

*Estimated.
**Reflects repayment of preassessed levy whenever a company came closer to meeting its quota than expected at the time of the spring assessment period.

Source: Ministry of Labor

Among the companies with one of the best records for hiring people with handicaps is the Japanese subsidiary of International Business Machines Corp. Although IBM Japan's average hiring ratio corresponds to the mandated 1.6 percent, the company goes beyond the usual adjustments of providing elevators and wider doorways to accommodate people with physical disabilities. For example, the firm grants special permission for the disabled to use a car in commuting and provides parking spaces for them at the company site, considered unusual in Japan.[11] For the 11 percent of its

Table 4: **Purposes to Which Employers Applied Grant Funds, FY 1991***

(in millions of yen)

Work Facilities	¥3,281
Equipment and Facilities	8,428
Independence of Severely Handicapped	6,257
Training	901
Special Employment Management of Severely Handicapped	1,203

*Estimated.

Source: Ministry of Labor

disabled employees who have auditory problems IBM Japan provides individual fax machines, electronic mail, sign language interpreters and hearing aids at conferences and meetings. The 4 percent of the disabled staff with sight impairment receive large-screen workstations and other aids that enlarge materials needed for their job. Nonhearing- and nonsight-related physical disabilities comprise about 78 percent of IBM Japan's hirings of those with handicaps. Among the jobs for which they are employed are: sales/systems engineers (19 percent); engineers in manufacturing development (19 percent); administration (47 percent); personnel (9 percent); and technicians (6 percent).

The current economic downturn is expected to have a detrimental effect on the hiring of people with handicaps in the near term. During past vibrant economic times, corporate health and concerns about a labor shortage improved the chances of Japanese with disabilities being hired. Now, however, incentives for hiring will have little appeal as companies vie for the cream of the crop among graduating college seniors for the reduced number of positions that they plan to fill next year. The levy/grant system lets companies make their own decisions on whether to hire or not, but without court-backed equal opportunity laws people with disabilities have little recourse — except, perhaps, to start their own business.

Improvements in Public Assistance

Under revisions to the National Pension Act in 1985 disabled people no longer considered dependents at the age of 20 can receive from the government the equivalent of what in America is SSI, Supplemental Security Income, a part of the Social Security program. If the recipient reaches a certain level of income through employment or receives money from other public assistance programs, the so-called invalidity pension payment is suspended. In 1990 the basic invalidity payment amounted to ¥877,500 ($7,000) a year for the most severely disabled and ¥702,000 ($5,600) for those with less severe but still very limited capacities. Separate provisions allow for additional annual increments of ¥202,400 ($1,600) each for up to two children (but only ¥67,500 or $540 for additional children). Although the general population is eligible for this basic social security program, only participants who contribute to a second employment-linked social security program (the Employees' Pension Insurance Scheme) can obtain benefits under less strict conditions. For example, if a person's disability is not as great as that required for the basic payment, he or she can receive a minimum of ¥526,500 ($4,200) a year.[12] A one-time lump-sum payment of ¥999,000 ($8,000) also is available to those who have been employed for a certain period but do not experience so severe a disability that they are considered eligible for the basic social security payment.

The improved system now means that "to become disabled does not necessarily mean to become poor," Mr. Maruyama notes. The arrangement allows the unemployed with disabilities — an estimated 70 percent of the physically handicapped population in 1987 — a better existence, although not a stylish one, he adds. However, as many as one-third of the families that have disabled members ranked among the poor in Japan in 1987, according to a survey that year that found nearly 33 percent had insufficient earnings to pay income taxes. This contrasts with the 16 percent of the general population exempted from income tax payments that year.[13] Those disabled or their families who do pay income taxes get exemptions or inheritance tax deductions to help cushion their financial situation. People with the most severe disabilities are entitled to a ¥330,000 ($2,600) national income tax exemption and a ¥260,000 ($2,100) credit on their local income taxes. Parents or guardians with a disabled child in 1987 were entitled to an income tax exemption of ¥140,000 ($1,100) on their national taxes and ¥80,000 ($640) on their local taxes.

Although the general trend in public assistance payments is downward (see Table 5), the proportion of welfare recipients who have sick or disabled household members is rising.[14] A calculation by the Management and Coordination Agency showed that in 1987 someone on welfare might have about two-thirds the income of an average worker after tallying basic assistance, allowances for an attendant or caretaker of a disabled person and housing allowances.[15] Examples of 1989 payments through the Ministry of Health and Welfare to households in which there are disabled members include: ¥12,380 ($99) a month to parents who care for their disabled child at home and ¥22,760 ($182) a month in the form of a special disability allowance. People who have disabilities and receive public assistance also can obtain special rates on bank loans for, among other purposes, rehabilitation, housing, tuition and nursing care. Discounts also are available from rail lines for public transportation and on automobile taxes. Families with limited means can obtain some special needs equipment at no cost, while those who can afford to pay can rent such items as braille typewriters and hospital beds at just a portion of their regular cost. Various cities also provide assistance above that provided under prefectural and central government auspices.

Table 5: **Trends in Public Assistance, FY 1985-FY 1990**

	FY 1985	FY 1986	FY 1987	FY 1988	FY 1989	FY 1990
	Average Monthly Expenditures (in millions of yen)					
Total Expenditures on Aid	¥126,940	¥124,323¥	¥121,170	¥115,811	¥114,058	¥109,838
Livelihood (Welfare)	44,799	42,759	41,131	40,058	38,375	36,667
Medical Care	70,537	69,853	68,248	64,034	63,933	61,491
Housing	8,272	8,478	8,619	8,637	8,678	8,549
	Average Monthly Payments (in yen)					
Payments to Invalids or Disabled						
One-Person Households	¥226,989	¥215,080	¥206,249	¥199,725	¥194,997	¥189,240
Households of Two or More	121,892	112,756	104,521	95,011	87,421	77,851

Source: Ministry of Health and Welfare

Uneven Distribution of Opportunities

Inspired by the United Nations' declaration of the 1980s as the Decade of Disabled Persons, Japan began paying closer attention to the needs of people with handicaps. The government set December 9 as "Disabled Person's Day" to be observed annually. A national congress was convened in 1981 to draw up a long-term plan for addressing the needs of the disabled. And, of Japan's 57 prefectures and specially recognized metropolitan centers, 54 began drafting their own long-term plans and programs.[16] One of the problems with the separate plans, however, is that wherever national standards are absent, access to benefits is uneven. For example, although the central government's role in building the Shinkansen rapid-transit train network helped to assure accessibility for the handicapped who use that mode of transportation, not all locally run subway and transportation systems have similar accessibility. Kyoto has made a point of ensuring that its subway system is accessible to wheelchairs, while Tokyo provides buses with lifts for wheelchair riders on some routes, Mr. Maruyama notes. Protests were planned this fall in various cities, however, to draw attention to the transportation problems of people with disabilities.

One hope that Mr. Maruyama harbors is that the government's interest in providing for the aging population will make available to the disabled population at large specially equipped buses and other facilities that enable better access and independence. Akiko Saito of the Japan Council on Independent Living notes, however, that government officials have been reluctant to extend assistance measures designed for the elderly to people with disabilities. She recently noted that people with disabilities and their advocates have won some concessions by pressuring officials. Ms. Saito also pointed out that advocates of people with handicaps often send clients seeking welfare assistance to the welfare branch for senior citizens "because they have more budget."[17]

Not all physical disabilities are treated equally, either. While the blind have benefited from some cities, such as Tokyo, providing coded bumps on sidewalks to help them negotiate street corners, the wheelchair-bound handicapped find few sloped sidewalks that allow them to cross streets more easily. In general, observers analyzing where the government could invest to jump start Japan's slumping economy have no trouble finding a number of infrastructure improvements that would help people with disabilities throughout the country.

The troubles faced by the physically disabled who are competing for attention from the central and local governments in Japan are a fraction of those confronting people with mental disabilities. Not until a revision of employment laws in 1987, for example, were people with mental retardation added to the list of disabled people covered by the hiring quota system. Moreover, only in FY 1989 did the government expand a daily assistance program that provides meal services and guidance for health care to people with mental retardation who live in group homes as a way of promoting alternative living arrangements for those with mental disabilities. "Livelihood assistance for mentally retarded persons in the community is considered ... a turning point from the institution-oriented program of the past and one of the most important issues in the future," according to the Japanese National Committee of the ICSW.[18] This year will mark the first nationwide sports competition for people with mental disabilities, even though games for the physically disabled have been promoted for roughly 30 years. Although people with mental retardation are beginning to see many of the same considerations under law as the physically disabled, the mentally ill have had a tougher time gaining acceptance.

Bringing Mental Illness Into the Open

In the words of a representative of Zenkaren (National Federation of Families with the Mentally Ill in Japan), "The image of mental illness is 'hereditary, incurable and dangerous.'" Although physical disabilities might be understood as arising from accidents or common diseases, the mysteries of mental illness make the Japanese (and many other people) uncomfortable. Zenkaren executive director Takehisa Takizawa notes, "If social welfare systems supported the mentally ill as much as they support the physically handicapped or the mentally retarded, no persons with mental illness and their families would hide any more. At present, however, the welfare systems for the mentally ill are quite behind [in Japan] and they cannot but hide."[19]

One stimulus for change hit the headlines seven years ago, when the media disclosed abuses and allegations of fatal beatings in a limited number of mental hospitals. The reports prompted lawyers and other concerned Japanese to ask for input from a Geneva-based nongovernmental organization affiliated with the United Nations Economic and Social Council. The International Commission of Jurists visited Japan in 1985 with the International Commission of Health Professionals and issued a highly critical assessment of the country's mental health system and its operations. As reported at that time, "unacceptable conditions of overcrowding, poor nutrition, ... physical abuse of patients, exploitation of patient labor, unjustifiable detention ..." and other concerns contributed to the group's conclusion that the mental health system then practiced was" ... conducive to inappropriate forms of care and serious human rights violations on a significant scale."[20]

Changes in the mental health laws in 1988 have improved the situation somewhat, according to the same group after an April visit this year. But the ICJ task force concluded that more revisions are necessary. It cited a "serious lack of resources, arising from the discriminatory nature of reimbursement of mental health care and welfare payments for the mentally ill as compared to other ill and disabled people."[21]

A major ICJ concern in 1985 was that the structure of the psychiatric hospitals appeared to encourage long-term stays, which served primarily to benefit physician/owners of the private hospitals rather than lead to a concerted effort to improve the patient's condition. The length of stay at psychiatric hospitals recently has averaged 500 days, according to Zenkaren. Some patients reportedly are hospitalized for as long as 10 years. To Zenkaren the 80 percent-plus private ownership rate of psychiatric hospitals means "the government has refused its responsibility for mental illness."[22] To other observers private ownership and lack of government supervision prior to reforms in 1988 have encouraged overcrowding and minimal patient care.[23] Critics question whether the increase in mental health beds in Japan has been driven by greed or need (see Table 6).

Table 6: **Mental Hospitals and Beds in Japan, 1980-89**

(as of October 1 of each year)

	1980	1985	1986	1987	1988	1989
Hospitals	977	1,026	1,035	1,044	1,048	1,047
Beds	308,554	334,589	340,506	347,196	352,504	355,743

Source: Ministry of Health and Welfare

After its latest review, which took note of the 1988 reforms to the Mental Health Act, the International Commission of Jurists acknowledged that the number of psychiatric beds had stabilized at about 28 beds per 10,000 population and that occupancy rates were now less than 100 percent. The average hospital stay also has been reduced but still remains above the international average, the panel noted. Among other major improvements were the increase in voluntary admissions and the creation of psychiatric review boards to serve as an appeals body for involuntary commitment. Prior to the 1985 ICJ review one government survey indicated that as many as 93 percent of patients in psychiatric hospitals had been committed involuntarily.[24] By 1989 that ratio had dropped. Still, patients in protective custody were the dominant portion of the population at 47.8 percent, according to the Japanese National Committee of ICSW. Protective custody admissions in Japan are those in which a guardian gives permission for hospitalization with or without the patient's consent. Some hospitalizations ordered by authorities might be aimed at protecting the potential patient from harming himself or herself, but these cases also can be initiated after an application by citizens or police and a diagnosis by two or more mental health physicians; such authorized hospitalizations formed 4 percent of admissions in 1989. About 44 percent of the admissions that year were discretionary.

Among the ICJ's recent recommendations was that involuntary commitment by a guardian no longer be allowed in Japan because "the existence of two different forms of involuntary admission creates a regrettable conflict of interest between the person to be admitted and his family members. The role of the family in committing the patient may seriously impede the patient's treatment."[25] Among other human rights issues decried by the ICJ group were: more than half the patients voluntarily undergoing treatment were put on locked wards and "the welfare system discriminates against mentally ill recipients by paying them approximately half of what is paid to the physically disabled."

The near-absolute authority of doctors in Japan, where few patients either expect or get full explanations of their health conditions, contributes to the difficulties in assuring mental health patients of their rights. But the government is able through legislation to provide an overall philosophy toward the care of the mentally ill. Further revisions of the mental health law are under consideration, possibly as soon as next year.

Another area in which the government has a direct influence is in the funding of more community-based mental health centers and outpatient treatment centers, considered key to discharging the estimated 30 percent of the inpatient population that could be treated on an outpatient basis if adequate facilities existed. The ICJ's April report noted that an experiment in Hokkaido had shown the feasibility of implementing a coordinated care system that involved community-based care.[26]

Outlook

Governments either set the tone of society's human rights policy, occasionally being in the forefront of opinion, or they reflect the views of society at large and work to change attitudes very slowly. In the realm of civil rights for people with physical and mental disabilities in Japan the government has tended to be a follower. For a society that prides itself on consensus that approach is not surprising. One result is that, once an approach is adopted, much of society already is well-informed and ready to take corresponding actions. A critical factor for the human rights of the disabled in any country, according to Mr. Dart of the President's Committee on Employment of Disabled People, is attitude, which he terms "99 percent of discrimination."

In pursuing passage of the Americans with Disabilities Act Mr. Dart often cited estimates that the cost to the United States of excluding the two-thirds of the American population with disabilities who are not now part of the mainstream is about $200 billion annually. That cost stems not only from lost productivity that could be captured if people with handicaps had better access to jobs but from the costs of inappropriate care when more people could be helped toward independence. When he spoke in Japan this September Mr. Dart noted, "The cost in other nations is equally punitive."

The paternal approach now followed in Japan has its own costs. Providing separate schools rather than equal access at all schools, for example, not only has a direct budgetary impact but impedes understanding of disabilities because able and handicapped students have less opportunity to interact with each other. Families of people with disabilities also face a direct cost when they have to pay whatever medical charges are not covered by the country's system of health insurance; conversely, the government's costs rise when inappropriate long-term care saps family budgets and requires coverage from public assistance or the long-term medical coverage program for lengthy hospitalizations.

The perils of paternalism also include its tendency to encourage halfhearted acceptance of the capacities of people with disabilities. At the same time the philosophy of mainstreaming in society has its problems, as evidenced by the number of homeless Americans who otherwise might be in mental institutions. Both philosophies require some oversight. "Father knows best" is not always true in cases of paternalism, because that protective philosophy can result in too many limits being placed on people who have much to contribute to society. Conversely, mainstreaming encourages equal access to opportunities but without follow-up could result in people with severe disabilities falling through the cracks that are present in any system.

Japan tends toward the "separate but equal" philosophy assailed in the United States by the 1954 Supreme Court decision banning racially segregated public schools. Integration has yet to be promoted on a broad scale in Japan, where the unfamiliar — unless in the form of a fad — has little acceptance. "Basic attitudes toward disability will take a long time [to change]," the National Council of Social Welfare's Mr. Maruyama says. "Same is comfortable; different is uncomfortable." Through the interaction of people working together, discrimination would be overcome on all levels, he argues, adding, "That's not just true of those with disability but for women, Asians, Koreans, foreigners."

For more information, contact **Pat Murdo.**

Notes

[1] Telephone interview with Harold Visotsky, Department of Psychiatry, Northwestern University, Chicago, Illinois, October 21, 1992.

[2] For a look at workers' compensation in Japan, see Richard E. Wokutch and Josetta S. McLaughlin, "The U.S. and Japanese work injury and illness experience," *Monthly Labor Review*, CXV, No. 4, April 1992, pp. 3-11.

[3] Japanese Society for Rehabilitation of the Disabled, *Rehabilitation in Japan 1988* (Tokyo: 1988), p. 183.

[4] *Ibid., p. 55.*

[5] Japanese National Committee of the International Council of Social Welfare, *Social Welfare Services in Japan* (revised 1990 edition) (Tokyo: 1991), p. 32.

[6] Japanese Society for Rehabilitation of the Disabled, *op. cit.*, p. 120.

[7] Interview with Ichiroh Maruyama, director, Department for the Welfare of Disabled Persons, National Council of Social Welfare, in Washington, D.C., September 2, 1992.

[8] Interview with Justin Dart, chairman, President's Committee on Employment of People with Disabilities, Washington, D.C., October 1, 1992.

[9] Remarks prepared for delivery by Justin Dart to the IBM Conference on Full Participation in a Modern Society, Tokyo, Japan, September 15, 1992.

[10] Dart interview, *op. cit.*

[11] Personal communication from Tadashi Saito, manager, Resource Management, IBM Japan Ltd., October 20, 1992.

[12] Social Insurance Agency, *Outline of Social Insurance in Japan 1990* (Tokyo: Japan International Social Security Association, March 1991), pp. 73 and 85.

[13] Japanese National Committee, ICSW, *op. cit.*, p. 69.

[14] Japanese National Committee, ICSW, *op. cit.*, p. 39.

[15] Cited in Japanese National Committee, ICSW, *op. cit.*, p. 43.

[16] Japanese National Committee, ICSW, *op. cit.*, pp. 63-64.

[17] Personal communication from Akiko Saito, Japan Council on Independent Living, October 26, 1992.

[18] Japanese National Committee, ICSW, *op. cit.*, p. 74.

[19] Personal communication from Takehisa Takizawa, executive director, Zenkaren (National Federation of Families with the Mentally Ill in Japan), as translated by Kazuyo Nakai, October 23, 1992.

[20] Alun Anderson, "Mounting pressure for reform," *Nature*, CCCXVI, No. 6029, August 15-21, 1985, p. 571.

[21] Press release from International Commission of Jurists, "Jurists Urge Better Protection for Mentally Ill in Japan," July 22, 1992.

[22] Takizawa, *op. cit.*

[23] Anderson, *op. cit.*

[24] Anderson, *op. cit.*

[25] International Commission of Jurists, *op. cit.*

[26] International Commission of Jurists, *op. cit.*

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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REPORT

A Two-Part Report: A and B

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Rising Trade Balance Hints At Weakening Economy In Japan

President Bush repeatedly has pointed to America's surging exports as a source of strength for the U.S. economy. But, with equal fervor, Bill Clinton as the Democrats' presidential candidate has implied that the preponderance of imports over exports is a source of economic weakness. If politicians in Japan applied either argument to that country's latest trade figures, they might have seen reason to brag. In 1992's third quarter Japan's dollar-denominated customs-clearance trade surplus rose a sizable 29.4 percent, pushed up by a 10.4 percent increase in exports (see Tables 1 and 2).

Few, if any, Japanese politicians took to the airwaves to claim credit, however. In fact, most probably viewed the data with some private despair — and not just because the numbers threatened to become grenades in the arsenal of critical American politicians. Both export and import figures illustrated some of the problems facing the Japanese economy. A Tokyo politician wanting to avoid controversy could be forgiven for hoping that the numbers would be ignored on both sides of the Pacific.

Virtually the entire 10.4 percent increase in exports was accounted for by the 9.3 percent appreciation of the yen between July-September 1991 and the third quarter of this year. The volume of exports rose a puny 0.8 percent, substantially below the rate expected from the growth of overseas markets alone. The strong yen, which reduces the profitability of export markets, appeared to put a brake on expected growth rates. Given that the Japanese currency has remained strong in October and that foreign economies continue to be weak, export sales are unlikely to rebound within the next few months. This suggests that foreign demand probably will not give the Japanese economy much of a boost.

Table 1: **Japan's Total Trade in Dollar Terms**

(in millions of dollars)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1987		$229,221	9.6%	$149,515	18.3%	$79,706
1988		264,917	15.6	187,354	25.3	77,563
1989		275,175	3.9	210,847	12.5	64,328
1990		286,948	4.3	234,799	11.4	52,149
1991		314,525	9.6	236,737	0.8	77,788
1990:	I	66,705	-2.2	54,383	6.3	12,322
	II	67,232	-0.5	53,954	5.2	13,278
	III	72,189	3.7	56,547	6.6	15,642
	IV	80,822	15.9	69,914	26.3	10,908
1991:	I	76,338	14.4	61,869	13.8	14,469
	II	73,992	10.1	56,283	4.3	17,709
	III	79,065	9.5	57,097	1.0	21,968
	IV	85,131	5.3	61,487	-12.1	23,644
1992:	I	82,444	8.0	57,429	-7.2	25,015
	II	80,871	9.3	56,840	1.0	24,031
	III (p)	87,264	10.4	58,832	3.0	28,432

Table 2: **Japan's Total Trade in Yen Terms**

(in billions of yen)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1987		¥33,315	-5.6%	¥21,737	0.9%	¥11,578
1988		33,939	1.9	24,006	10.4	9,933
1989		37,823	11.4	28,979	20.7	8,844
1990		41,457	9.6	33,855	16.8	7,602
1991		42,360	2.2	31,900	-5.8	10,460
1990:	I	9,766	12.2	7,941	21.9	1,825
	II	10,449	13.3	8,392	19.9	2,057
	III	10,651	7.5	8,364	10.8	2,287
	IV	10,592	6.1	9,159	15.7	1,433
1991:	I	10,183	4.3	8,257	4.0	1,926
	II	10,225	-2.1	7,775	-7.4	2,450
	III	10,853	1.9	7,846	-6.2	3,007
	IV	11,099	4.8	8,023	-12.4	3,076
1992:	I	10,523	3.3	7,317	-11.4	3,206
	II	10,613	3.8	7,470	-3.9	3,143
	III (p)	10,951	0.9	7,393	-5.8	3,558

Table 3: **Japan's Trade with the United States in Dollar Terms**

(in millions of dollars)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1987		$83,580	3.9%	$31,491	8.4%	$52,090
1988		89,634	7.2	42,037	33.5	47,597
1989		93,189	4.0	48,246	14.8	44,943
1990		90,322	-3.1	52,369	8.5	37,954
1991		91,538	1.3	53,317	1.8	38,220
1990:	I	21,661	-4.7	12,753	9.9	8,908
	II	20,938	-9.0	12,861	6.6	8,077
	III	22,933	-4.9	12,729	2.1	10,204
	IV	24,790	6.2	14,025	15.7	10,765
1991:	I	22,311	3.0	13,268	4.0	9,043
	II	20,304	-3.0	13,464	4.7	6,840
	III	23,719	3.4	13,185	3.6	10,534
	IV	25,205	1.7	13,401	-4.4	11,804
1992:	I	22,771	2.1	13,528	2.0	9,243
	II	22,121	9.0	12,765	-5.2	9,356
	III (p)	24,808	4.6	13,006	-1.4	11,802

Table 4: **Japan's Trade with the United States in Yen Terms**

(in billions of yen)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1987		¥12,148	-10.4%	¥4,582	-6.8%	¥7,566
1988		11,487	-5.4	5,388	17.6	6,099
1989		12,816	11.6	6,632	23.1	6,184
1990		13,057	1.9	7,586	14.4	5,471
1991		12,324	-5.6	7,191	-5.2	5,133
1990:	I	3,171	9.4	1,862	26.0	1,309
	II	3,254	3.7	2,000	21.4	1,254
	III	3,384	-1.5	1,885	6.3	1,498
	IV	3,249	-2.8	1,838	6.1	1,411
1991:	I	2,977	-6.1	1,770	-4.9	1,207
	II	2,806	-13.8	1,860	-7.0	946
	III	3,255	-3.8	1,812	-3.9	1,443
	IV	3,287	1.2	1,749	-4.8	1,538
1992:	I	2,905	-2.4	1,725	-2.5	1,180
	II	2,904	3.5	1,677	-9.8	1,227
	III (p)	3,113	-4.4	1,634	-9.8	1,479

The import numbers are as worrisome for government and business analysts in Japan as the export figures. Dollar-denominated imports rose 3 percent in the July-September period from a year earlier, but currency fluctuations explained all that apparent growth and then some. In reality, the volume of imports decreased 1.4 percent. Compared with other Japanese economic indicators, however, this decline was relatively modest. Industrial production, for example, dropped a preliminary 6.2 percent in the third quarter from a year earlier, suggesting that imports probably gained market share in a weak economy. The tentative conclusion is that the strong yen is lifting imports above levels they otherwise would reach at precisely the time when firms that compete with imports are feeling most beleaguered. Together with the weak export numbers, the import data suggest that the yen's strength is exacerbating the recession from the standpoint of Japanese manufacturers.

The latest quarterly figures on trade with the United States are equally discouraging from a Japanese perspective (see Tables 3 and 4). The data suggest that Japan's surplus, as measured by either dollars or yen, continued to increase through September, with the full quarter imbalance rising 12 percent as measured in dollars. Tokyo was spared a fusillade of criticism from Washington or the political hustings, since American politicians seldom use Japanese data concerning the bilateral imbalance to make their arguments even when, as in this case, the comparable U.S. numbers will not be available until after the November 3 elections. While Japanese bilateral volume data are not directly available, the weak growth on both sides of the trade ledger, coupled with a stronger yen, suggest that import and export volumes both declined in the July-September period from the year-earlier level. The underlying economic weakness in both countries that contributed to the decline in Japan-U.S. trade hardly counts as a political plus in either Tokyo or Washington.

Douglas Ostrom

Japan Raises Concerns About North American Trade Pact

When the trade ministers of the United States, Canada and Mexico symbolically strengthened a commitment to more closely link their three economies by initialing the text of the North American Free Trade Agreement October 7, Japan and other third countries were distant, but not disinterested, observers. Since the mid-August completion of the NAFTA talks representatives of countries that are not a party to NAFTA increasingly have voiced concerns about the proposed pact. Although Japanese government officials expressed support in principle for the free trade arrangement, they emphasized that the accord should bolster the international trade system and not impose barriers to nonparticipants pursuing trade and investment opportunities in the region (see *JEI Report* No. 32B, August 21, 1992). Japan's ambassador to the United States, Takakazu Kuriyama, conveyed his government's apprehensions about the new free trade arrangement in a letter to U.S. Trade Representative Carla Hills this summer. In several forums since then Japanese officials have reiterated their concerns regarding the potential impact of NAFTA on worldwide trade.

In a late September meeting of the Pacific Economic Cooperation Council in San Francisco Parliamentary Vice Minister for Foreign Affairs Koji Kakizawa cautioned: "Utmost care is necessary in order to prevent regional integration from leading to external discrimination and the formation of regional trade blocs." He added, "Questions have begun to be asked whether the United States ... has shifted its emphasis from a global to a regional approach." Possible discrimination against third countries under the new trade agreement, which still must be approved by the legislatures of the three participants, was among the issues raised by Japanese officials during the September 30-October 2 meeting of the U.S.-Japan Trade Committee (see *JEI Report* No. 38B, October 9, 1992).

Moreover, in an October 21 meeting with visiting Canadian business and political leaders Prime Minister Kiichi Miyazawa directly addressed Japanese concerns about the North American free trade arrangement. He repeated Tokyo's conviction that NAFTA should be consistent with international trade rules under the General Agreement on Tariffs and Trade. The prime minister was